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BANKING

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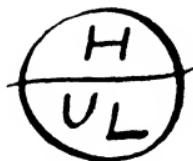
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Banking

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OXFORD UNIVERSITY PRESS

LONDON NEW YORK TORONTO

1948

First published in 1948

PRINTED IN GREAT BRITAIN

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To
SYDNEY MOORE

AUTHOR'S NOTE

FOR THE figures on page 27. I am indebted to Mr. W. F. Crick and Mr. John Wadsworth (both of the Midland Bank); for those on pages 134 and 135 to Mr. Geoffrey Crowther, Editor of *The Economist*; and for those on page 106 to the Editor of the *Bankers' Magazine*.

I have to thank the Librarian of the Institute of Bankers for untiring help, and my friend Mr. R. W. Jones for reading and improving my manuscript.

CHAPTER I

AT THE SIGN OF THE UNICORN

BANKING, LIKE most other occupations, has its dull patches, but they are not nearly as numerous as the general public seems to believe. There are few days that do not bring something of interest, and not even machine accountancy has eliminated the satisfying sense of old traditions and a storied past.

To-day, Lombard Street is discreetly paved with rubber blocks, while great modern offices tower over it on either side. But the decorated signs hang out as they did three hundred years ago, and some of them would be recognized at once by any Caroline City man permitted to revisit the scenes of his former activities; for over Lloyds Bank he would see the Black Horse that once adorned the shop of the 'little goldsmith Stokes', and a few yards nearer Gracechurch Street, on the same side of the road, he would be greeted by the Grasshopper decorating Martins Bank, emblem of that institution's descent from the Greshams. If the ghost were that of Pepys he would doubtless be stimulated by the vastly instructive changes. His first reaction, perhaps, might be grief at missing the sign of the Unicorn, which in his day marked the business residence of his friend Alderman Backwell, banker to the King and to a score of other notables. The diarist's quick interest, however, would soon pass to a consideration of the exciting present and be particularly seized by the evidence of foreign trade provided by the presence of the Crédit Lyonnais and the Guaranty Trust

Company of New York; while the office of the Commercial Bank of Scotland would probably cause him to let loose a flood of questions as to the progress of the troublesome Presbyterian kingdom.

Yet Pepys and his contemporaries were, comparatively speaking, late arrivals in Lombard Street. In and around this street men have worked out by trial and error for two thousand years the problems bound up with the exchange of one article for another. Here the trader from Gaul, the yellow-robed Jew, the North Italian merchant banker came in a long succession, drawn by custom and geographic advantages, and the last-named of these visitors gave to the street its present name and to our commercial vocabulary such words as 'cash', 'ledger', 'debtor', and 'creditor', not to mention the mystic letters L.S.D. By the time of the Commonwealth, however, such rudimentary banking as existed had nearly all fallen into the hands of English goldsmiths, who drifted into being bankers through their willingness to guard other men's valuables. Their business was a hotch-potch of pawnbroking, gold-and-silver smithery, money-changing, and true banking. They dealt with the nobleman who wished to purchase or pledge plate, the merchant who desired to remit funds to Amsterdam or Antwerp, the Navy Office official who had to fit out ships and was consequently obliged to raise money on his royal master's credit.

The rapidly growing financial requirements of the State were already bringing prosperity to this community of Backwells, Duncombes, and Vyners, when their medieval houses were suddenly destroyed by the Great Fire, which left 'Fanchurch-streete, Gracious-streete and Lombard-streete all in dust'. But recovery was rapid, as may be seen from the fact that in April 1669, less than

three years after the Fire, Backwell is recorded as taking Pepys into his shop to show him 'the model of his houses that he is going to build in Cornhill and Lumbard Street; but he hath purchased so much there that it looks like a little town'.

There is plentiful evidence that these Restoration bankers had a thorough working knowledge of their art. They issued receipts for the gold deposited with them for safekeeping, but their operations went far beyond this. It did not take them long to learn that, so far as coin was concerned, the deposited wealth might more than earn its keep. Only a few of the depositors were likely to demand all their money back at any one time and, as a general rule, most of it would lie criminally idle unless the bankers did something about it. Fortunately, there were plenty of reputable people anxious to borrow at rates as high as 20 per cent. per annum and it was the bankers' pleasure and duty to bring money and borrower together.

The next technical advance took place when some astute lender of high commercial standing thought out an even more lucrative method of obliging borrowers; instead of parting with coin, he persuaded the borrower to accept a piece of paper bearing the lender's promise to pay coin on demand. The issuer's unimpeachable reputation would then cause the written promise to pass current as money and circulate perhaps for some weeks before a holder would present it for redemption. Sometimes, however, the holder would desire to deposit the bank note (for such the promise was) with his banker until he needed to spend it, and this act of deposit was a convenient way of establishing a current account. The stage was now set for the appearance of what has grown

to be the most important of credit instruments, the cheque. As long as the depositor merely wished to withdraw money for his own personal requirements the order to his banker was nothing but a letter passing direct from creditor to debtor, but when the depositor decided to transfer a claim to money to a third party the cheque proper took shape, although in its early days it masqueraded under the name of 'drawn note'. A specimen of one of the earliest of these is set out below and is interesting as showing how like in effect to our cheques these early orders were:

MR THOMAS FFWOLLES

I desire you to pay unto Mr. Samuel Howard or order upon receipt hereof the sum of nine pounds thirteen shillings and sixpence and place it to the account of

Yr servant

EDMOND WARCUPP

14 Augt 1675

£9. 13. 6.

ffor MR THOMAS FFWOLLES GOULDSMITH

at his shop between the two

Temple gates fletee streete.

Another early specimen, drawn on Messrs. Childs (bankers to Nell Gwynne and somewhat unkindly immortalized as Telson's Bank) by the Duke of Bolton, is payable 'unto ye Reverend Doctr. Tytus Oates or his ordr', but as reward for what shady service we shall never know.

So, before the arrival of Dutch William brought Amsterdam financiers to show the English commercial world how the most advanced financial centre conducted business, Lombard Street (and its thriving offshoot round Temple Bar) had developed the use of the bank note, the

current account, the commercial bill of exchange, and the cheque. The Fire of London destroyed what would have been an invaluable set of records for historians, but we are fortunate in having preserved for us Backwell's ledgers for the years 1663-71. In their faded pages we find what a wide range was covered by the great goldsmith-banker—loans, bills discounted, investments in trading enterprises, the accounts of provincial customers, 'the King's Most Excellent Majesty Ac.'—and, significantly, accounts maintained with him by other and lesser goldsmith bankers. Here in something more than embryo we have a forerunner both of one of the Big Five and of the Bank of England.

The double curse of the Plague and Fire proved insufficient to shake the solidity of these goldsmith-bankers. Several of them were, however, unable to stand the burden placed on them by the constant borrowings and infrequent repayments of the State. In 1672 Backwell and half a dozen of his competitors found themselves ruined, or at least badly hit, by the repudiation known as the Stop on the Exchequer. Victorian historians, living in an age when the budget was always balanced and a pound was a sovereign, were unanimous in condemning the Stop as an unpardonable fraud. We, unfortunately accustomed to the shifts and stratagems of an empty treasury, can more easily see that Charles II and his advisers were bound to get into money troubles because war was becoming far too expensive to be financed by means of the old-fashioned fiscal system. That their difficulties were not merely heaven's judgement on Charles's mistresses and the secret French Treaty was proved by the fact that good King William was plunged into worse difficulties still when he came to the throne.

Largely as a result of the Anglo-Dutch war against France, Parliament had to sextuple its grants between 1689 and 1696, and in spite of this increase in revenue the Government was obliged to borrow very extensively.

As might be expected, these years saw many expedients on the part of the Treasury; and the Treasury did not lack plenty of lay advisers, for the second half of the seventeenth century was a period particularly rich in 'projects'. Perhaps the most fertile of the projectors was William Paterson, a truly extraordinary Scot, and out of one of his plans was born the Bank of England. State banks were no rarity even at that date. The Banco di Rialto at Venice had been established for over a century, the Bank of St. George at Genoa was older still, and the City of Amsterdam's bank had developed during eighty years into one of the most important financial institutions of the day. All these were alike in being carefully regulated and in being dowered with special advantages over the rest of the banks, so that nothing could have been easier than to imitate the structure of one of them when the English Government decided to set up a bank by law.

Our rulers followed none of the precedents, and what was to become the world's greatest bank finds its origin almost casually in a few clauses of the Tunnage Act of 1694. The effect of the legislation was to allow anybody who so wished to join in subscribing £1,200,000 to found a limited liability company to be incorporated under the title of 'The Governor and Company of the Bank of England'. Once the money was raised the Bank had to lend it all to the Government at 8 per cent. and, in return, received the right to engage in a wide variety of banking operations for an initial period of twelve years. It is reasonable to inquire where lay the value of this

'privilege of banking', since all the Bank seemed likely to dispose of as cash was the interest due on the money lent to the Government. In fact, however, no coin found its way to the Treasury, for the loan was made in the form of the Bank's own promissory notes payable to bearer (i.e. bank notes), and the greater part of the subscribed capital thus remained available for day-to-day business uses.

But unlike its continental brethren the Bank of England received at the time of its foundation no kind of monopoly whatever and it is accordingly not surprising that in its early years the directors had many anxious hours. As a distinguished economic historian has said: 'That the Lords of the Treasury avoided national bankruptcy was a remarkable achievement; that the Bank did not immediately collapse was even still more remarkable.' For more than a decade the young institution struggled on in open competition with unhampered rivals; it established current accounts and provided pass books; it issued interest-bearing promissory notes and ordinary bank notes; it did not object to engaging in high-class pawnbroking; and (a significant move) before long it undertook to discount foreign bills for its customers at very moderate rates. At last came the reward of patience—in 1707 the Government, now more deeply than ever in debt to the Bank, prohibited the issue of bank notes, and the carrying out of certain other operations, by any concern (other than the Bank) possessing more than six partners.

The effects of this Act were to prove of enduring importance to England and Wales. At that time, and for long after, note-issuing was a necessary activity of any bank which wished to expand its business, and the new

legislation made it impossible for any large-scale bank other than the Bank of England to be established south of the Tweed. Thus all through the eighteenth century the country was denied the opportunity of enjoying the services of large multi-branch banks that could ensure the safety of deposits by spreading their risks over a wide variety of businesses. Scotland, excepted from the provisions of the Act, was able to develop in a rational manner, with the result that, in spite of her comparative poverty, she acquired a much more reliable credit structure than England and in the nineteenth century sent out a long line of able men who transplanted the Scottish system to every part of the Empire. The restriction nevertheless brought one advantage, in that the type of banking it encouraged fostered the 'country banker', the small partnership that became expert in the affairs of a particular region and a particular set of families. The pleasant relations which grew out of that pattern have in many cases survived the great amalgamations of the twentieth century and still generate a friendly banker-customer current which proves valuable in good and bad times alike.

Contact between employer and employed also was close in these little banks, though that must often enough have proved a doubtful blessing to the clerks. Paternalism had its stern side in those days and it was not the manual operative alone who was 'improved' by the master. Warrington was the headquarters of the banking dynasty of the Parrs and in the parish church five pews were reserved by the firm for the use of its clerks. The renting of pews in Warrington church has fallen into desuetude these eighty years, but the old lists still bear witness to the earnest determination that bank clerks

should have their steps guided on the seventh day as much as on the other six.

The development of trader into banker was not rapid in the provinces, for the first half of the century was one of slow expansion, and such capital as was needed for large-scale development was provided, in the main, by the initiative and out of the pockets of a few wealthy men. There was no class of manufacturers in the modern sense of the word; the very term 'manufacturer' denoted in that age a person working with his hands, and industrial riches were largely concentrated in a small number of merchant middlemen. Little capital was invested in fixed plant except for shipping, canal-transport, and agriculture, and Burke in his *Regicide Peace* gives figures which indicate that in 1750 there were hardly any 'pure' bankers in England and Wales outside London.

The Industrial Revolution, with its sudden expansion of all kinds of commercial enterprises, gave a tremendous stimulus to banking. The dozen or so country firms mentioned by Burke had increased within fifty years to over three hundred, and Macleod, one of the classic historians of banking, speaks contemptuously of the shopkeepers, grocers, tailors, and drapers who sprang up like mushrooms, turned bankers, and inundated the country with their 'miserable rags' of notes. The part played by the almost unrestricted right of note-issue was of the greatest importance in the development of English banking. Outside London there seems to have been little or no exercise of it prior to the middle of the eighteenth century, but with the coming of specialized banks this profitable method of making something out of one's good reputation was to prove so popular that by 1775 Parliament found it necessary to forbid the issue of notes for

less than £1, and two years later the minimum figure was raised to £5.

The number of London banking houses did not show such a rapid expansion but it nevertheless managed to double itself between the sixties and the end of the century. Curiously enough, progress was unconnected with issuing notes: by the mid-seventies London banks had mostly ceased to issue, having found that cheques and Bank of England notes met all their needs. They made their profits by dealing in bills, financing merchants and manufacturers, and acting as London agents for their provincial brethren. None of the country bankers did their metropolitan business through the Bank of England, and most of the Scottish banks placed their interests in the careful hands of their fellow-countryman, Mr. Coutts of the Strand.

The English prohibition of large partnerships and of joint-stock banking naturally encouraged the correspondent system, but it also led to a linking of firms. Abel Smith, the Nottingham draper-banker, joined a Payne in London and by 1774 we find Smith, Payne and Smith established in the Lombard Street offices which they occupied until they became a part of what is now the National Provincial Bank. Taylors, Lloyds and Bowmans similarly joined together Birmingham and London interests, while the enterprising Joseph Jones of Manchester and Llandovery set up a City office—Jones, Loyd and Co.—on which the two provincial members used to draw 'Jones on Jones' bills which were rudely christened 'pig on pork' by other bankers.

The outstanding example of linked banking houses was that provided by the Quaker family of Gurney, whose partnerships, by 1800, stretched right across East Anglia

and had close ties with the Barclays and the Bevans in London. But the Gurneys were only one of a host of Quakers who by the end of the eighteenth century had set themselves up as private bankers in the territories bordering a line drawn from Brighton to Darlington, and by their endless intermarriages established family trees in comparison with which that of Galsworthy's Forsytes is simplicity itself.

In Scotland, banking was mainly represented by the Bank of Scotland (founded 1695), the Royal Bank (1727), and the British Linen Bank (1746). Notes for £1 (£12 Scots) were issued by the Bank of Scotland very early on in its career and they have continued to be a common currency right up to our own day. There was nothing in Scots law to discourage (and much to encourage) these banks in branch-opening. The Linen Bank had agents all over the country to further the industry from which it drew its name and much of its wealth, and these agents circulated its notes. The Bank of Scotland had opened more than twenty branches by 1800, and the Big Three all proceeded on an assumption at that time thought absurd in England—that the small depositor was worth attracting, and that when he was hardworking and thrifty he was worth helping.

Apart from the Jews, whose specialized and highly valuable contribution to the City is reserved for a later chapter, the only other feature of eighteenth-century banking that demands notice is the important one of the growth of the Bank of England. As has been said, the Bank started life under unfavourable auspices (the canny Duke of Marlborough took no shares until he knew all was well, and he sold as soon as he saw a respectable cash profit) and for twenty-five years it had to battle with

the difficulties created by a Government that was only too ready to listen to seductive offers of loans from big competitors such as the East India Company and the South Sea Company. The help given by the Bank during the years from Blenheim to the Peace of Utrecht nearly sank the giver but nevertheless constituted an unanswerable claim to consideration once the period of danger was over. The speculative boom which we remember under the title of the South Sea Bubble got rid of the parliamentary lobbying of one adversary, while time and growing eastern commitments transferred John Company into the biggest borrower at Threadneedle Street.

Walpole secured our country twenty years of peace when it was badly needed and his policy of *laissez-faire* suited the economic circumstances of the time so well that when the Seven Years War came it found the Bank of England able to ride the storm without much effort, as may be seen by the fact that in 1762 the Government was able to borrow at 4 per cent. Lord North (who was no fool in financial matters) was hardly exaggerating when he said of the Bank in 1781 that it had grown 'from long habit and usage of many years . . . a part of the constitution'.

Throughout the century, until the great crisis of 1797, the Bank paid its shareholders dividends of from 5½ to 7 per cent. The coming of the Walpole era brought in a long period of low interest rates and the Bank had to accept less and less per cent. for its increasing loans to the State, so that by 1750 the rate on the debt was a mere 3 per cent., compared with 8 per cent. at the date of the Bank's foundation. Where did the extra profit come from, out of which to pay the higher dividends and to lay by the requisite reserves? This question cannot be

answered with any precision, for the Bank of England has never been very communicative regarding its profits and losses. Until the Napoleonic Wars the discounting of bills was moderate and the rate charged was limited both by the general fall in interest rates already mentioned and by a faithful observance of the Usury Laws, which fixed a maximum of 5 per cent. Dealings in gold and silver bullion, though impressive to the outside public, were likewise only a moderate source of income. The big profit-makers appear to have been the note-issue and the great round-figure loans to concerns such as the East India Company, while the commission for putting into circulation Exchequer Bills (the Government's short-term promissory notes) was one largely consisting of pure profit.

So strongly established had the Bank become that the War of American Independence left its financial structure unimpaired. The Revolutionary Wars which broke out in 1793 were to prove a different matter. Pitt's policy of loans and subsidies to continental allies, the demand for all sorts of necessary foreign products on a rising market, and, ironically enough, the powerful demand by France for gold to carry out a recoinage, all operated to turn the exchange against sterling and to drain gold from the country. Nevertheless it was not until 1797 that the Bank found itself nearing the point when it could no longer be sure of possessing the coin with which it was legally bound to meet its notes if so requested; but when the evil hour came the Government promptly put through an Act to relieve all banks of the obligation to honour their notes. This suspension of gold payments lasted until 1821 and provided an incentive to country bankers to issue paper on an increasingly generous scale. It was not long before the paper pound showed some signs of being

worth less than a gold pound, although the pre-war price of £3 17s. 7½d. per ounce was not seriously exceeded until after 1808. The maximum was £5 7s. od. in the dark days before Waterloo, but by the end of 1815 the favourable turn of events had brought the figure back to £4 2s. od. In the light of our experiences during the years since 1914, this discount on the paper pound does not seem a very serious matter and it is doubtful whether the English people, other than currency experts, worried very much about it at the time. What they did worry about was the rise of prices connected with the depreciation in the value of the paper currency; and the experts, though they were at loggerheads as to the exact relation between the *inconvertible* bank note and the level of prices, were in general agreement that there was a relation and that for the England of 1815 a return to convertibility was highly desirable.

That return came in 1821, with a Bank selling price of £3 17s. 10½d. an ounce for gold bars, and from then to 1914 any person possessing a Bank of England note had something 'as good as gold'. The owner of the notes of a country bank was not always in the same happy position: about 2 per cent. of the issuing banks broke yearly and during a serious crisis as many as 10 per cent. might suspend payment. This tendency to close doors at inconvenient moments can be readily understood in the light of the fact that in 1825 (a bad crisis year) Yorkshire possessed fifty-six issuing banks, Devon thirty-four, and Kent thirty-one! The description of one such failure has come down to us in a letter Charles Lamb wrote to a friend in 1810:

'The city of Salisbury is full of weeping and wailing. The Bank has stopt payment; and every body in the

town kept money at it, or has got some of its notes. Some have lost all they had in the world. It is the next thing to seeing a city with a plague within its walls. The Wilton people are all undone. All the manufacturers there kept cash at the Salisbury bank; and I do suppose it to be the unhappiest county in England this, where I am making holiday.'

The fall of provincial banks was always liable to damage those London banks which acted as their agents. In December 1825, when a financial panic swept the country, the indivisibility of economic conditions was painfully illustrated by the failure of six London banks, the first to fall being the powerful firm of Pole and Co., agents for forty-four country banks.

Meanwhile, Scottish banking had weathered the storm in an admirable manner and advocates of joint-stock multi-branch banks were not slow to point the moral. Fortunately, the Prime Minister, Lord Liverpool, had already prepared the necessary legislation and in 1826 an Act was passed permitting the setting-up of corporations and co-partnerships of any number of persons with power to issue notes outside a radius of sixty-five miles from London, within which radius the law remained as it had been heretofore. Another measure passed at about the same time prohibited the issue of notes of a less denomination than £5 in *England*, where the small note had crept back during the Napoleonic wars, but the attempt to force the Scots to abandon their £1 variety proved an ignominious failure. The permission to establish joint-stock banks was unwelcome to the country bankers, nor did they at first appreciate the simultaneous action of the Bank of England in sallying out and setting up several branches in the provinces. New joint-stock

banks were slow in appearing, however, which is not surprising when it is remembered that legally they were only huge partnerships with unlimited liability. The pressure on the old-fashioned country banker came rather from the Bank of England's branches. Local bankers used these branches for the purpose of discounting bills when they were short of funds, and if the Bank thought that the means of payment were increasing faster than circumstances warranted, it was now possible to bridle the country banker by raising the rate at which his bills were taken. At last the Old Lady of Threadneedle Street was able to make her presence felt in Loamshire as in Lombard Street.

The Bank's Charter was due for renewal in 1833 and the opportunity was used to pass an Act which included a clause making clear the legality of establishing joint-stock banks *within* the sixty-five mile radius provided they did not issue notes. Both the Bank of England and the private London bankers were very angry about this but Parliament was too strong for them, and before the year was done a group of Noblemen and Gentlemen had drawn up the prospectus for a non-issuing London joint-stock bank to be called 'The London and Westminster Bank'. History was to show that the Bank of England's fears for itself were unfounded, but the arrival of the London and Westminster was rightly recognized as the beginning of a movement which would engulf the private bankers who had flourished from Fenchurch Street to the Strand for nearly two hundred years.

The new bank was at once made to feel that it was unwelcome. The private bankers refused to allow it the use of their clearing house, where inter-bank debits and credits were daily offset to the great saving of everybody's

time and temper. The Bank of England refused to allow the newcomer to open an account and refused to discount any bills made payable with Gilbart, its famous manager. But the battle was lost—during the next ten years the Old Guard had to submit to the arrival of the London Joint Stock Bank, the National Provincial, and, significant of the new world that was opening up, the Bank of Australasia, the Bank of British North America, and half a dozen other Colonial banks.

The changes brought in by the Act of 1833 let loose a ten-year flood of arguments and inquiries regarding joint-stock banks, note-issue, and currency legislation. The agent that crystallized the various plans was Peel. Once more the Charter was due for renewal and Peel was of all men the one best able to use the opportunity to make a long-term settlement, if such a thing were possible. It was, and his Bank Charter Act of 1844 laid down the pattern which governed the general development of British banking for seventy years. The City's Golden Age had dawned.

CHAPTER 2

THE MIDDLE YEARS 1844-1900

THE BANK CHARTER ACT was a compromise between two monetary theories known respectively as the Currency Principle and the Banking Principle, but its provisions represented, on the whole, a substantial victory for the former. These theories, and their numerous variants, had been hammered out during the years following the Napoleonic Wars and are important as representing the two opposed schools of thought which are always liable to propound their teaching regarding the role of note-issues and of the precious metals in a nation's house-keeping. Circumstances gave to the Currency Principle an ascendancy in England that lasted until the First World War, so that by our fathers' days it had become accepted as axiomatic, but the long economic earthquake to which the world has been subjected since 1914 has brought up for reconsideration many long-neglected nostrums, among them being the Currency Principle's forgotten rival.

Stripped of its various adornments and refinements, the Currency Principle states that if a country uses paper money instead of gold with a view to economy and convenience, then that paper money should never exceed the gold reserve in quantity. The gold reserve would tend to rise or fall in response to changes in the country's balance of international payments and receipts but at any one time there would exist a simple and automatic

answer to the question of how many notes ought to be in circulation. In order for the Principle to be translated into effective action the right of note-issue must be concentrated in the hands of a single authority, which, to ensure the legal convertibility of its notes, will be bound to try to correct heavy effluxes of gold by doing something to attract money back to the country. The advocates of the Currency Principle considered the Bank of England to be the obvious instrument, but the more clear-sighted of them saw that the Bank would then be performing two distinct functions. On the one hand it would be issuing notes in quantities subject to a statutory and mathematically ascertainable check; on the other it would be carrying on the ordinary banking business of accepting deposits, discounting bills, and so on. The solution, however, was not difficult: all that was necessary was to divide the Bank into two parts to correspond with the twofold nature of its activities.

This neat mechanism was denounced by the Banking Principle men as being unworkable, yet it is typical of early-Victorian thought that few people were found to suggest that the management of the nation's currency should be one of the duties of the State. The Banking Principle's adherents were ready to concede that a centralized note-issue could be made to vary with the inflow and outflow of gold and in response to the warning movements of international rates of exchange; but there were also the ups and downs of internal trade to be considered and these might bear little or no relation to the movements of world affairs. This view was put strongly by the *Bankers' Magazine*, a periodical which still speaks its mind bluntly once a month. Looking back at the first two years' experience of the Bank Act, it said:

'We adopt the view of the great body of practical bankers examined and cross-examined before the committee of the House of Commons on this subject. They all bore consistent testimony to one great fact—that the country issues *could not* be regulated by the accidental condition of the foreign exchanges.'

The function of the country bankers' note-issues was to expand and to contract *pari passu* with commercial requirements in the provinces—but it was the right to expand that probably most attracted 'the great body of practical bankers', many of whom derived large profits from their note-issuing rights.

How heavily the Act of 1844 lent towards the Currency Principle may be seen from a brief summary of its major provisions relating to note-issues. No further note-issuing banks were to be allowed to appear; no existing bank could increase its note-issue beyond the current figure; and amalgamations or rearrangements which increased the number of partners in a bank to beyond six were to involve the withdrawal of any note-issue rights hitherto possessed. The Act went on to split the Bank of England into an Issue Department and a Banking Department. The Issue Department, as its name implied, was to be the originator of statute-controlled notes and was compelled by law to hold gold (or, if it wished, silver up to 25 per cent. of the gold) against its notes *in excess* of what was impressively christened the Fiduciary Issue. The Fiduciary Issue was a quantity of notes, at first fixed at £14 million, of which about £11 million was offset on the other side of the balance sheet by the long-standing debt of the Government to the Bank, while the remainder was offset by actual Government stock. The Bank was given power to decrease the Fiduciary Issue but could only

increase it by obtaining permission to make additions up to two-thirds of the amount of some bank's lapsed issue. No decreases were ever made, but the lapsing provision resulted in raising the Fiduciary Issue to £19½ million by 1928, when new arrangements were made.

With the statutory division of functions went a modest attempt at enforcing publicity. The Act decreed that the Bank was to publish a weekly return showing separately the assets and liabilities of the two Departments, other note-issuing banks were made to print weekly returns of their outstanding paper money, and all banks had to publish annually a list of partners.

The Bank Charter Act was accompanied by another Act whose effect was to make it a very cumbrous matter to set up any new joint-stock bank. This measure was repealed in 1857 but during the thirteen years it was in force it fulfilled its object of discouraging fresh large-scale ventures; its very success, however, allowed existing joint-stock banks to consolidate their position free from the competition of newcomers. The paucity of statistics makes detailed comparisons impossible, but there is no doubt that from now on the joint-stock banks were not only increasing in importance relatively to the private banks but had also started gradually to squeeze the latter out of business, a process which, continued steadily over the next seventy years, resulted in the elimination of all except a small handful of very strong firms.

The enemies of the Bank Charter Act did not have long to wait before being able to justify some of their criticisms. The gold-cum-currency provisions of the Act broke down under the impact of the financial crisis of 1847, when it was found necessary to suspend the rule

restricting the Bank's right of note-issue. Similar suspensions occurred in 1857 and in 1866, but thereafter the Bank never again needed to go to the Chancellor of the Exchequer to seek a relaxation of the iron law which controlled the quantity of fiduciary paper money. That skilful management played a great part in keeping the note-issue along the lines laid down in 1844 cannot be doubted, but Providence took a hand also by revealing to mankind fresh mines from which could be obtained the large additional quantities of gold required to underpin the vast and rapidly increasing volume of mercantile transactions of a world where government after government followed the example of England by establishing their currencies on the gold standard.

The gold standard formed the framework within which the whole of British banking and commerce did its job during seventy years of unparalleled expansion and prosperity, and some explanation of the way it worked may reasonably be interposed here. A country is said to be on the gold standard when it keeps the value of its monetary unit (pound, dollar, or what you will) equal to the value of a fixed weight of gold, and is at the same time willing to buy and sell gold at the price resulting from this equation. In gold standard days the pound sterling (the sovereign) contained 113.0015 grains of pure gold. This fixed relationship meant that an ounce of 'standard' gold (eleven parts of gold to one part of alloy, known as eleven-twelfths fine) was worth £3 17s. 9½d., and the Bank of England was bound by law to pay £3 17s. 9d. for every ounce of standard gold offered to it and to demand £3 17s. 10½d. for every ounce it sold. The observance of these rates, together with the freedom to import and export gold, made it certain that five British

sovereigns and a Bank of England £5 note were interchangeable terms.

As other countries followed suit, it was moreover possible to fix rates of exchange based on the immutable gold contents of the various national monetary units. The United States gold dollar contained 23.22 grains of pure gold; the British sovereign contained 113.0015; therefore one pound sterling was, in terms of gold, equal to 4.8665 dollars. This arithmetic parity is called the par of exchange and round it, under a gold standard, working rates fluctuate according to the play of supply and demand and are very sensitive in their response to the complex of forces making up a nation's balance of international payments. Payments inwards to the United Kingdom are made (ultimately, anyway) in sterling, while payments out are made in foreign currencies. Besides the settlements called for by the import and export of goods, there are payments to be received and made for services such as the supplying of shipping space and the giving of insurance facilities. Moreover, a rich country may lend money to a poor one and the latter will have to remit back money to pay interest on the loan. When a country's payments exceed its receipts it has an adverse balance of payments and the deficit can be reduced either by cutting down imports and services received or by increasing exports and services rendered—or, as a temporary measure, resort can be had to borrowing from abroad to make good the gap. If none of these corrective measures proves adequate, then the deficit can only be met by paying gold to the creditors.

Before this point has been reached, however, the movement of the balance of payments will have been reflected in the rates of exchange, for the excess of imported goods

and services will have had to be paid for ultimately in the currency of the suppliers, thus tilting the demand and supply scales against the currency of the debtor country. But in a gold standard world the rate cannot move far from the par point, since, if it did, creditors would demand actual gold. The actual amount of depreciation must in fact be limited to round about the cost of shipping gold from the debtor country to the creditor country, and when the rate of exchange of a national currency reaches this level it is said to be at the export gold point. Conversely, a country possessing an excess of foreign receipts over foreign payments will see its currency appreciate in value and draw near to the import gold point.

The correction of variations serious enough to bring the rate of exchange for sterling past these two warning limits was one of the tasks of the Bank of England. The main corrective instrument was the 'bank rate' and its effectiveness largely depended on the willingness of the other British banks to vary their own rate structure in conformity with the movements at the central institution. At first sporadic non-co-operation seems to have been in evidence; but as the century progressed it became unusual for any large bank to leave its rates out of alignment, and no small bank dared to exercise a bold non-conformity. The bank rate is the rate at which the Bank of England is prepared to discount for non-customers first-class bills of exchange bearing two English names, and it soon became customary for all the other rates in the money market to be fixed with regard to it. The commercial banks' rate for discounting first-class bills, for instance, is fixed a little lower than bank rate and the rate they charge on loans and overdrafts is fixed at a conventional level above bank rate. The Bank of Eng-

land's action in raising its discount rate, and so all other rates, would attract to an England working under the gold standard foreign funds seeking a more lucrative opening than they could find at home. This attraction would show itself in a demand by foreigners for sterling and thus start to tilt the exchanges in favour of the pound. A lowering of the bank rate would have the opposite effect.

In addition to rate manipulation the Bank of England has always possessed another weapon, albeit one which circumstances have brought into play only since 1918. This is the one called 'open market operations', and it has been employed in the following two ways. At a time when the monetary authorities feel that the supply of credit and money in circulation is excessive the Bank can enter the market and sell some of its holding of Government securities. The money paid by the buyers will reduce their balances in the commercial banks and so reduce those banks' lending powers. Action to increase the supply of credit takes the opposite form: the Bank appears as a buyer of securities and so can pump money into the general banking system; but each of these initiatives is necessarily limited, under a gold standard or any other rigid standard, in the one case to the Bank's holding of available securities and, in the other, to its holding of available cash.

The gold standard worked well because the assumptions on which it was based were, on the whole, valid. It postulated a free trade or, at least, a low tariff world, a world that knew nothing of 'quotas', 'compensation agreements', and all the other shifts and stratagems with which we have become unfortunately familiar during the past twenty years. When any exchange moved to the export gold point, gold was allowed to move out from the

country concerned and credit was restricted in order to maintain the legal or customary proportion (whatever it might be) between notes and gold, while a movement to import gold point witnessed a reversed order of action. This arrangement came to be accepted as being as natural as the circulation of the blood because a general feeling of security prevented people in one gold standard country from moving their money to other centres through fear that their own government would abandon the standard. Of course capital movements (mainly international loans) did occur, and on a large scale, but they usually took place under the superintendence of experienced bankers and being closely related to the commercial needs of the world did not disturb the general equilibrium.

Within this framework, then, England (and other countries) prospered. Countries exported the goods or commodities which they were best fitted by their economic structure to export, and they imported the goods that it was worth their while to buy abroad. In the United Kingdom the role of the commercial banks in overseas trade was indirect until the twentieth century, for they left the bulk of the financing of imports and exports to a few specialist institutions—the merchant banks, bill houses, and so on. One reason for this standing aside is to be found in the fact that the commercial banks had plenty of other problems to engage their attention. The great increase in the nation's wealth during the Victorian Age brought with it numerous changes in the structure of industry. Small factories became big, businesses amalgamated; and, as a consequence, banking operations grew larger, with giant customers demanding giant overdrafts. This trend made it desirable for banks

both to increase their resources and to spread their risks, so it is not surprising to find fusions among manufacturing and trading concerns matched by similar movements among their bankers.

An idea of the changes thus brought about can be obtained by comparing three sets of figures showing the situation in 1844, 1884, and 1904 respectively:

1844					
	No.	Branches	Capital and Reserves (£ thousands)	Note-Issue (£ thousands)	
Private banks	336	71	?	5,153	
Joint-stock banks	105	486	9,488	3,478	
1884					
	No.	Branches	Capital and Reserves (£ thousands)	Note-Issue (£ thousands)	Deposits (£ thousands)
Private banks	207	443	?	1,439	146,000 (estimate)
Joint-stock banks	118	1,621	61,624	1,531	282,000
1904					
	No.	Branches	Capital and Reserves (£ thousands)	Note-Issue (£ thousands)	Deposits (£ thousands)
Private banks	40	196	?	160	?
Joint-stock banks	65	4,414	81,700	517	584,163

Bank of England Note-Issue: 1844 £20.2 million;
1884 £25.1 million;
1904 £27.8 million.

These tables have some unavoidable gaps because the published statistics for private banks are meagre, but they show in broad outline how the joint-stock banks gradually spread at the expense of the private ones and they show also how the note-issues decreased as the years went by. The first change would probably have occurred in any event, but it was hastened by an Act of 1862 according the right of limited liability to shareholders in joint-stock banks, while the second was the result of the spread of the habit of keeping a current account and, consequently, of using cheques. It will also be noticed that side by side with the growth of the banks' deposits and the number of their branches there took place in the later Victorian period a rapid acceleration of fusions and absorptions, so that in 1904 there were barely half as many separate joint-stock banks as there had been twenty years earlier. In 1884, even the largest among them were what might be termed regional banks, confining their branches to particular areas of the country, with the result that a Lancashire bank, for example, tended to have too great a proportion of its loans and discounts tied up in the cotton textile trade, while an Eastern Counties bank might often be similarly over-committed to the agricultural interest. The long trade recession of the eighteen-eighties emphasized the presence of this weakness, as it did that of so many others, and English and Welsh bankers hastened to remedy it by developing nation-wide networks of branches.

In the development of North Country or Midland joint-stock banks there was bound to come a time when expansion into fresh districts could only be achieved by setting up offices in the Home Counties. A southward invasion meant competition with those banks which

possessed headquarters in London and which had already established branch systems in and around the metropolis. For the raid to be successful the interloper needed something more than ability and capital—he needed a seat in the London bankers' clearing house, the jointly-owned institution where the members met daily to sort out and set off their mutual claims and square any differences by handing each other cheques on their Bank of England accounts. Unless it had a place in that convenient club, a bank had to employ the services of a member, a situation leading to delay and, for any large bank, to a loss in prestige. The most rapid and economical method open to a provincial bank wishing to secure a footing was to buy up one of the metropolitan banks already in possession of a seat. The result was that a second-rate London bank could sell itself dearly and behave in a very lordly fashion toward concerns of much greater intrinsic strength. A good illustration is provided by the closing page of the history of the Royal Exchange Bank. In 1888 that institution found itself in low water after a chequered and even stormy career, but it also found itself able to exact a high price for its corner in the clearing house, for the flourishing Birmingham Banking Company was seeking to follow the lead given by Lloyds Bank five years earlier and set itself up in the 'City'. Shortly afterwards the Midland Bank also entered London by a similar door, and eventually the two organizations joined forces, absorbed the powerful London Joint Stock Bank in 1918, and ended up as the Midland Bank of to-day, the largest of the Big Five who dominate the English banking scene.

No description of the response of English banking to the changing conditions would be complete without a

reference to the spectacular fusing of the Quaker interests whose activities under the Gurney leadership have already been mentioned. In 1896 Barclays, Bevans, Gurneys, Tukes, Seebohms, Backhouses, and half a dozen other prominent families decided that their interconnection was of far too loose a kind to withstand the invasion of their territories by the joint-stock banks now everywhere seeking fresh conquests. The invitation to union came from Barclay & Co., who had a London office and the necessary clearing house seat, and no better proof of the decay of private banking need be sought than the decision of the fifteen partnerships involved to effect their amalgamation in the form of one big joint-stock bank. The witness to their wisdom stands visible for all to see in the massive head office of Barclays Bank Ltd., on the north side of Lombard Street, and in that bank's great network of branches reaching into the remotest parts of England and Wales.

It would be a mistake, however, to overlook certain other financial houses which never sought to lay branch unto branch but remained satisfied to carry out activities different from though ancillary to those pursued by the giants of the trade. The London market owed much during the nineteenth century to merchant and investment banks, from old-established and historic houses such as Rothschilds and Baring Brothers to the adventurous small concerns founded to make profitable use of a highly specialized knowledge of foreign trade and foreign bills. They created for London an international reputation as the place par excellence where both small- and large-scale borrowers from abroad could come for loans to develop their commercial projects and their countries. Not all the lending was wisely done (in 1890 Barings

were barely saved from downfall by the co-operative action of the whole banking community) but by 1914 the great loan-issuing houses could not unjustly claim that it was largely by their efforts that Britain held in fee not only the Gorgeous East but the greater part of the rest of the world as well. The loans created a continuing claim for interest and attracted to this country a steady flow of orders for machinery, textiles, and coal, orders usually evidenced by bills of exchange which were traded in on the money market like a commodity and which provided a very cheap method of transferring debts and claims.

CHAPTER 3

THE PASSING OF THE GOLD STANDARD

1900-1939

THE EARLY years of the twentieth century, though they brought warnings that the long period of peace and stability might be drawing to a close, were in many respects a time of successful consolidation. The foundation of the vast credit superstructure received spectacular reinforcement from the South African gold discoveries, while slowly rising prices and interest rates stimulated new commercial enterprises without disturbing unduly the relation between debtors and creditors. In the United Kingdom, the last grumbles against the supremacy of the Bank of England were dying away and its co-ordinating functions were coming to be unquestioningly accepted. For many years every clearing bank had kept part of its resources with the Bank of England on current account; and, as provincial banks kept part of *their* 'cash' with the clearing banks, the Bank of England was *perforce* the central depository of the entire country's monetary reserves and, for that reason, well placed to measure the community's need of credit. The amalgamations which distinguished the period between 1900 and 1925 were of a nature to strengthen the Bank's hold over the money market, for they rapidly reduced the number of financial institutions which had to be consulted, conciliated, or coerced. But the fusions were chiefly notable by reason of the fact that, though the process of the

strong absorbing the weak continued, the very large banks were starting to cast around for equally powerful organizations with which to coalesce. The union of the London and County Bank and the London and Westminster Bank in 1909 showed that even the biggest metropolitan banks might see fit to come together; but this fusion remained unique of its kind until the First World War released forces which ended in the creation of the great concerns we know to-day. The remaining absorptions up to 1914 were chiefly those by London joint-stock banks of provincial undertakings, a good example being the taking over of the North and South Wales Bank by the Midland Bank in 1908. In one part of the country the efforts of the metropolitan absorbers met with little success: the industrial North of England, where local patriotism had for generations been reinforced by local wealth, though it was the scene of fusions between prosperous Lancashire and Yorkshire banks, provides more than one instance of resistance to any suggestion of playing second fiddle to the South. To this attitude we owe, for example, the continued existence of the institution now known as the District Bank, with its head office in Manchester, and the belated yielding of several other fine old concerns, such as Messrs. Beckett & Co. of Leeds, who waited until 1920 before accepting the offers of the Westminster Bank, their London agent.

There were three other important extensions of English joint-stock banking activity associated with the period inaugurated by the First World War—a move into Scotland and Ireland, a move into overseas countries, and a direct participation in the foreign exchange market. For some years, more than one ambitious general manager had been casting covetous eyes on the thriving industrial

belt north of the Tweed. Should English banks leap the barrier or should they attempt to gain their ends indirectly? The experience with the stubborn Lancashire and Yorkshire banks suggested that an 'arrangement' would be preferable to a frontal attack. Barclays Bank led the way in 1919 by securing the affiliation of the British Linen Bank; and the ink on this agreement was hardly dry before the Midland Bank announced that it had obtained control of the Clydesdale Bank, an expansion carried further by a similar contract in 1924 with the North of Scotland Bank, whose branch system provided a natural northward extension to that of the Clydesdale.

The move into Scotland had been preceded by one into Ireland. Through an exchange of shares in 1917 the Midland Bank acquired control of the Belfast Banking Company's eighty branches and sub-branches, while the same year saw the passing of the powerful Ulster Bank to the Westminster Bank. Though both these Irish banks retained their separate existence, a certain amount of hostility was engendered in an Ireland very conscious of its own interests, and no other venture of a similar type has been undertaken.

It is worth noting that we owe to the Royal Bank of Scotland a move in the opposite direction. In 1924 it already maintained a branch office in London, but it then spread from the City to the West End by the purchase of the private bank of Drummond & Co. and the acquisition of the Western Branch of the Bank of England, and later it established an even wider authority by obtaining control of Williams Deacon Ltd., an old-established joint-stock clearing bank with valuable North of England connexions. The Irish made no similar move

but they had already been represented in England for many years by the National Bank, which operated a network of branches from London while at the same time carrying out a similar type of enterprise at home.

Amalgamations between banks which were already big led to much talk of the dangers to be expected from a 'money trust'. The fusions in question had taken place in an atmosphere of fierce competition, with the leading protagonists anxiously scanning each other's moves and balance sheets, but it was obvious that a day might come when England would find itself with but two joint-stock banks, both of them willing and able to agree to enforce monopoly terms on the consumers of their services—able also, perhaps, to challenge the authority of the Government. In 1918, the then Chancellor of the Exchequer set up a Treasury Committee on Bank Amalgamations. Unfriendly critics maintained that its membership was too heavily weighted with bankers; if that complaint was true, then the approach to unsocial monopoly conditions must have appeared dangerously near, for the Committee reported: 'We . . . recommend that legislation be passed requiring that the prior approval of the Government must be obtained before any amalgamations are announced or carried into effect.' The report went further and recommended that proposals for interlocking directorates and affiliations should be subject to the same restraint.

The result of all this was peculiarly English. A parliamentary Bill was drafted but never pushed through, so that there exists to-day no statutory bar to amalgamations or fusions, but there has nevertheless come into being an understanding by which proposals for further aggregation have first to receive the Treasury's blessing.

How far amalgamations have been thereby hindered it is hard to tell. Fusions of various kinds went on briskly for a year or two after the Committee had reported, and then they fell off. It was known that a union between any two of the Big Five¹ would be vetoed, but difficulties of administration were already putting on a brake, difficulties still evident to-day, twenty years after the pattern of English banking assumed its present shape.

The check to internal aggrandizement may have been a factor making for the acquisition of subsidiaries across the seas. Government encouragement during the war years of 1914-18 certainly played a part, not always with happy results. The Westminster Bank set up then in Spain, France, and Belgium; Lloyds Bank and the National Provincial combined to operate in France, Belgium, and Switzerland; but the great ventures were to come later, mainly through the enterprise of Lloyds Bank and Barclays Bank. Lloyds turned towards Latin America and acquired various controlling interests in banks which are now consolidated in the Bank of London and South America, an organization represented in no fewer than seventeen countries and possessing a chain of offices stretching from Guatemala to Patagonia. This affiliation has been more than matched by the series of absorptions carried out by Barclays Bank in order to form Barclays Bank (Dominion, Colonial and Overseas) Ltd., whose branches are to be found in three large clusters in the West Indies, the Middle East, and British Africa. In addition to these moves there has gone on the whole time an interlocking of directorates whereby the same names appear on the board of one of the Big Five

¹ Midland, Barclays, Lloyds, Westminster, National Provincial.

and those of banks operating in foreign parts, but too much should not be deduced from this, for often enough it means little more than that the latter maintain an account with the former.

The direct participation in the foreign exchange market by the big banks dated from about 1907, when the Westminster Bank and the Midland Bank set up offices capable of handling all the foreign business requirements of their customers. This new venture proved a great success, and by 1919 every clearing bank had its foreign branch or foreign department through which were passed enormous quantities of bills and shipping documents relating to the country's imports and exports. Nor were the commercial interests the sole beneficiaries; with the end of the First World War, foreign travel became more popular than it had ever been before and the banks laid themselves out to deal with all the monetary requirements of the large number of people taking holidays abroad.

These activities of the big English banks drew to them the London funds of banks established abroad and of numerous foreign businesses and individuals. During the early part of the nineteen-twenties, when many European currencies were depreciating rapidly and erratically, the steady sobriety of sterling attracted continental residents who feared to keep their savings at home. London became a favoured refuge for holdings of stocks and shares, the dividends from which could be placed to the owner's sterling bank account with complete secrecy. The vast complex of transactions and the erratic behaviour of exchange rates made necessary a drastic modernization of the day-to-day methods of buying and selling foreign currencies. No longer was

it sufficient for a few dignified gentlemen to spend an hour or two in the Royal Exchange setting off their various claims; the new needs had to call in the modern aid of electrically-controlled telephone switchboards and the market for the commodity became highly specialized. The banks, through whom were expressed the countless demands for foreign currencies and for sterling, did not normally deal direct with each other but preferred to call into existence a great cluster of foreign exchange brokers working on commission. Under the pre-1914 conditions, when rate movements were too narrow to attract the speculator's interest, such a sensitive and elaborate machine would have been wasted; but in the hectic years between the two wars it was ideally fitted to perform a function that brought a considerable foreign income to our balance of payments. The climax to the activity of the non-commercial side of the market came in 1936, when the formation of the Popular Front government in France led to a widespread export of funds from that country. Thousands of new banking accounts were then opened in London and a considerable portion of these fresh customers lodged gold bars for safe custody, as well as stocks and shares. This incursion was by no means altogether welcome, for the money had flown to England in a panic and might as easily fly away again. The name of 'hot money' was given to this type of deposit and time was to show that the forebodings about it were justified.

The new developments to which we have referred took place in a difficult and rapidly changing world. The amalgamations and extensions of the years from 1914 to 1925 were largely a response to the demands of the times. The great war which had shattered the almost unbroken

peace of over forty years set in motion innumerable forces which, in combination, broke up the worldwide economic structure that owed so much to British leadership and on whose continuance that leadership partly depended. For four anxious and terrible years Britain was drained of her wealth and suffered a devastating loss of young men. The latter misfortune was plain for all to read in the long casualty lists, but the diminution of our riches was masked in several ways. One factor which helped to conceal the real state of affairs was the Government's decision to maintain the existing rates of exchange in spite of a continuing adverse balance of payments. As far as the ordinary citizen could see, the gold standard still functioned, the only obvious difference being that gold coin was called in, the public receiving instead bits of paper carrying a promise to pay the bearer one pound or ten shillings as the case might be. What the bearer would in fact be paid for his note was a question that most people were too busy or too worried to ask. As the gold standard was still theoretically in existence, the answer should have been gold, but the Government, by virtually prohibiting the export of the metal, made it seem a waste of time to discuss the point. Though this ban on gold exports constituted an effective departure from the old standard, the subsequent depreciation of paper money in terms of gold was prevented from reflecting itself in the exchanges, for by selling off our international securities and by borrowing from abroad our monetary authorities were able to keep up appearances. This procedure, known as 'pegging' the rate, is one of those games that is usually only worth playing if a considerable amount of prestige is at stake, and it cannot be played indefinitely. Once the war was brought to a successful

close, official control ceased and the peg was removed, with the result that the depreciation of the paper pound was exposed for all the world to see. The rate against United States dollars, which had been held at 4·86½ for four years, was allowed to seek its true supply and demand level and promptly went to between 3 and 4 dollars to the pound. Similar movements were seen in the quotations against those other currencies, such as Swedish crowns, which had not themselves fallen in value during the years of hostilities, but the Government entertained the whole time a belief that it would yet prove possible to put the Humpty Dumpty pound back on the wall where he could look the dollar in the face once more. The methods employed by the Treasury and the Bank of England to attain this resurrection are still the subject of somewhat acrimonious discussion but they did succeed in enabling Britain to return to the gold standard¹ at the old dollar parity by 1925—a very considerable achievement. Our example was followed by the rest of the Empire and by most of the European states which had been driven off the gold standard by the post-war financial troubles, so that by 1927 the various central banks could congratulate themselves and each other that things were back to normal. Nine years after the guns ceased firing the gold standard held sway over a wider area than ever before; but little more than two years later there began a rapid series of events leading to a second breakdown which has lasted to the present time.

The reasons for this débâcle have been hotly debated and the various arguments are set down in innumerable

¹ As there was no return to a free minting of gold, and gold was not brought back into general currency, the system was called the gold bullion standard.

books for the instruction of those interested in monetary theory. Though it is not necessary to maintain that the downfall was due to any one cause, as the events of those years recede into better perspective it is difficult to disagree with the view put forward not long ago by Mr. Frank Paish, one of our younger economists, when he said :

'The main cause of the breakdown was the premature transfer of the key position in the world economic system from the United Kingdom to the United States. This would certainly have happened sooner or later in any case; but the war, by weakening the economic position of Britain and strengthening that of U.S.A., caused the transfer to take place before America was either psychologically or politically ready for it. The United States has a long record of economic instability. Of all the world economic crises of the nineteenth and early twentieth centuries, only one, or at most two, originated outside the United States. Now that the world had become dependent on her, not only as an importer but as a foreign lender, a major crisis in the United States was bound to have the most serious repercussions on the rest of the world. With a depression in America of the dimensions of that of 1930-33, no international financial system, or absence of system, could have prevented the rest of the world from sharing acutely in its effects.'

The gold standard, as has already been said, was a kind of game; and it had to be played according to certain rules by which prosperous countries lend abroad boldly. The U.S.A., enriched by the events of 1914-18, after sallying out into the world as a lender, became frightened at her own problems and hastily drew in her horns, thereby precipitating the great slump that darkened nearly the whole of the nineteen-thirties.

It was not to be expected that the banks of Britain

would be able to avoid the impact of the widespread depression. The commercial collapse which came at the close of 1920 had brought them heavy losses, particularly over shipping and textile loans, but the long-drawn-out ordeal to which they were now to be subjected was much worse. During these years, the wisdom of the banks' innumerable foreign ventures was severely tested. The largest debtor was Germany, much of whose borrowing had taken the form of what are called acceptance credits. Because of the important role it has played in the London money market this type of finance deserves more than a passing mention. It grew out of the requirements of foreign trade and therefore reached its finest flowering in the greatest of international trading cities. An importer who orders goods from abroad often finds it inconvenient to pay until after he has taken possession of them. The seller, on the other hand, may be unwilling to part with the merchandise except against cash; or, though willing to grant credit, he may insist on granting it only to an undoubted and well-known person. For two parties who know little or nothing of each other the existence of a first-class intermediary is of the greatest value, and in London, the capital of the world's heaviest importing nation, there conveniently grew up firms of merchants whose names became widely known as drawees of bills of exchange. These firms in course of time became willing, for a commission, to lend their names as drawees to importers enjoying a lesser reputation; later still, with some of them, this enterprise of accepting bills on behalf of others grew to be the main part of their business, so that they became known as Accepting Houses. Paper bearing their name had the advantage of being easily discountable at better rates than ordinary commercial

bills and came to form a substantial part of the credit instruments in which a money market trades. Confidence breeds confidence, and the belief of civilized mankind in the creditworthiness of sterling and of these acceptors led to a vast number of shipments being financed by this means even when neither the exporter nor the importer lived in the United Kingdom. During the First World War the big banks also started to grant acceptance credits as part of that direct intervention in foreign business to which reference has been made, and when the great depression came they and the Accepting Houses found themselves with £64 million outstanding on German account alone. Both Accepting Houses and banks were working on borrowed money, the money deposited with the banks by their millions of customers, and they relied on the people on whose behalf they had accepted being able to provide funds to meet the bills as these fell due. In market parlance, the acceptors had been borrowing 'short' and lending at three months. The smash came when continental credit-takers, principally Austrian and German banks, proved unable to provide foreign exchange (sterling or dollars) to meet the bills accepted on their behalf.

For many years thereafter, critics of the London market cited this unfortunate failure as an example of the shortsightedness of the banking community and it cannot be said that the accused put up a very convincing defence. Yet the defence was there: the risk had been a fair trade risk; banking is often a risky business; the direct and indirect profits had in the past been large, bearing witness to prudent enterprise; it was a matter of world importance to set the wheels of Central Europe turning once more and these credits had been granted

for that purpose and with the encouragement of the British Government; the diversion of financial supremacy from Britain to the U.S.A. created difficulties that nobody at that time could measure. As it was, the volley of abuse generated by the news of the German default resulted in people overlooking the one certain bit of bad judgement on the part of the lenders. After the initial failure, it became possible to accept an arrangement for part-payment, an arrangement gladly accepted by the American banks involved. For some reason or other (perhaps under Government pressure) the British creditors held out sternly for their full rights—and got nothing.

This burden of debt weighed with particular severity on the smaller concerns in the London market and some of them never recovered. The big acceptors, mainly large banks, were, however, able to write off their losses without difficulty; but the unhappy experience has not been forgotten either in England or in the U.S.A.

The presence in the market of large numbers of foreign bills obscured the diminishing part played by inland bills, those drawn within the country by one trader on another. Readers of Anthony Trollope's novels will be familiar with the manner in which mid-Victorian gentlemen financed their more pressing wants by putting their names to bills of exchange—or getting other gentlemen to put theirs—which were presented for payment at most inconvenient times. Although the same writer has made a passing reference to the speculative financing of guano and kauri gum, the romance of the far more numerous commercial bills has lacked a narrator, in spite of the rich material available in the annals of the commercial crises that punctuated the secular upward swing of gold standard England. The settlement of debts was greatly

facilitated by the drawing of bills. For example, once a sixty-day commercial bill was accepted by the debtor, the creditor could get it discounted by a banker and so obtain immediate cash while leaving the buyer of the goods in the enjoyment of credit until maturity. There existed means to make public any failure to meet engagements of this kind, so that acceptors could usually be relied upon to honour their obligations except in times of general crisis. It is not easy to ascribe to any one cause the passing out of fashion of this method of debt collection, though the dislike of buyers to having bills drawn on them must have become an important reason during the numerous years of bad trade which darkened the interval between the two wars. A more lasting reason may be found in that process of industrial amalgamation which had called forth a corresponding movement among banks. The large combines which were more and more coming to dominate many branches of manufacture and distribution preferred, for various reasons, to carry on their business without either drawing bills or being drawn upon. This did not mean, as might have been expected, that they increased their borrowings from the banks by way of loans and overdrafts; no such good fortune came the banks' way. A combine may occasionally need to get hold of very large sums of money but it rarely feels the lack of a few thousands of pounds, for if one branch or side of it is pushing out and feeling a temporary need of cash, another branch will be in a slack phase and have funds to spare. Inter-borrowing becomes convenient and the bank has to look elsewhere for a profitable use of the money entrusted to it by its depositors.

Between the two wars, this and other causes led to a

marked modification in the 'shape' of the banks' assets. Before 1914, and indeed right up to 1932, it could be said that advances to customers employed about half the money shown on the liabilities side of the balance sheet as Total Deposits. From the banks' point of view this was a very satisfactory state of affairs, since the percentage profit to be obtained from loans and overdrafts was greater than that derivable from any of the other earning assets. The great depression brought a severe contraction in business enterprise, with a consequent calling in of existing advances and a lack of openings for sound new ones. Interest rates also fell as commercial venturers drew in their horns, while the economies attendant on industrial combination accelerated the aggregating of separate medium-sized businesses into non-borrowing combines.

It was not long before the force of all these circumstances was reflected in the banks' balance sheets. The percentage of total deposits used as advances fell rapidly from 1932 until, by 1935, it averaged only 38.5 per cent. Thereafter it recovered somewhat but it never regained its former conventional level even under the stimulus of the rearmament drive, and at the end of August 1939 the proportion was but 43.9 per cent.

Money that could not be used for advances had to be employed some other way. 'Bills discounted' could not help, as the inland bill was hurriedly vanishing from the face of the earth. 'Money at call and short notice'—money lent to finance billbrokers and such folk for a day or two or over-night—was not susceptible of increase in the conditions then ruling. Investment in stocks and shares and Government bonds could not be carried past a certain point, for too extensive a tying up of money in

that direction offended against the sound banking canon that assets must be kept in a form permitting of quick withdrawal without loss. An outlet from the blind alley was found through the Government's action in raising funds by the issue of Treasury bills payable at ninety days. These instruments were issued to the highest bidders at weekly auctions, and they gave the banks a useful earning asset whether the banks bought them direct or, as more usually happened, they found their way to the banks through rediscounting for the bill-brokers. Treasury bills had figured in the money market for many years but their quantity increased considerably as time went by. Between March 1925 and the end of 1938 the total outstanding rose from less than £600 million to nearly £1,000 million, and though the rate of profit to be made out of investing in them grew less and less (in 1938, for example, it averaged a mere 0.611 per cent. per annum compared with 4.146 per cent. ten years earlier), they were used thankfully as a very convenient short-term outlet for the vast volume of deposits created by the actions of a Government no longer restrained by the salutary checks inherent in the gold standard. This increase in clearing bank deposits—they rose from £1,657 million in December 1925 to a figure of £2,246 million in August 1939—was in fact a potent factor in preventing bank earnings from falling with the fall in interest rates; and the Government's 'cheap money' policy, ushered in by the huge operation in 1932, whereby War Loan was converted from a 5 per cent. to a 3½ per cent. basis, found support from the banking community partly because bankers' profits were protected against the full shock by the expansion in deposits.

The history of world banking over the twenty years

from 1919 to 1939 contains much to confirm one in the belief that British banking was carried on with great probity, courage, and ability during a period of hitherto unparalleled difficulty. Over the whole of that time no bank of any size operating in the United Kingdom either failed or came under suspicion. No statutory superintendence was in existence, every measure of control was of a voluntary nature; yet never once could the stability of our banks be called in question by the most hostile critic. In some other equally developed modern States the story was far different. The fall of the great Darmstадter Bank in 1931 was the prelude to a drastic reorganization of German banking. Important banks failed in Italy and France; and in the United States, the richest country in the world, banks failed in thousands, while one of the largest New York institutions found itself involved by the actions of its President in a scandal which shook confidence as much as could the bankruptcy of a hundred lesser concerns. Something of all this deserves to be remembered when the shortcomings of our banks are dilated upon by those who conceive of banking as no more than a set of rule-of-thumb operations solemnly executed by gentlemen in neat black jackets and striped trousers.

CHAPTER 4

THE SECOND WORLD WAR

1939-1945

THE RENEWAL of the struggle with Germany drove British banks further along the road they had been travelling during the later thirties and forced them, in addition, to face new problems. On the very first day of war the Government assumed control of the whole financial machine through the powers embodied in the Defence Regulations. The foreign exchange market was shut down, so it became impossible to buy or sell currencies except at rates fixed by the Treasury, and all deals had to be carried out with the Bank of England acting as the Treasury's agent instead of between bank and bank through the intermediary of a broker. The pound sterling, which had climbed back so arduously in 1925 to its old parity with the dollar, and even risen to a premium on New York when Roosevelt devalued the United States currency in 1933, was immediately abased to 4·03 and its value in terms of other currencies such as Swiss francs and Dutch florins fell correspondingly. Any resident who owned or subsequently came into possession of any of a long string of foreign currencies had to deliver them in exchange for sterling, while a wide range of foreign stocks and shares were swept into Government depositories and in due course sold off in order to raise dollars. The nation's stock of gold, most of which had for some years been mysteriously hidden within a fund called the Exchange Equalization Account, disappeared

entirely into the secret places of the Treasury and was heard of no more. Most of the existing bank loans to persons residing outside what was called the Sterling Area¹ were called in and no fresh ones were made, and the Treasury expressly discouraged even home lending except for purposes connected with the war effort.

Not many weeks passed before the Defence Regulations set a clear mark on the day-to-day operations of Lombard Street. Special departments had to be established in every bank to interpret and work the multitudinous rules and orders which poured out from the Bank of England. Dealings in securities or in imports and exports involved the filling up of endless forms, the accounts of persons resident in enemy or enemy-occupied territories had to be separated from the rest and be made the subject of voluminous statistics rendered to the Trading with the Enemy Department of the Board of Trade, and accounts of customers living in other lands had to be classified country by country, each country or group of countries being subject to its own rules of procedure. Then came list after list of 'specified persons' branded as having had dealings with the enemy, and every bank had to scan the names in case one of its overseas customers had been included and thereby been doomed to have his assets immobilized. Nor did the banks' services stop at dealing in money. When clothes rationing came along, traders soon found difficulty in clearing the millions of coupons passing from the consumer through the retailer to the ultimate supplier of

¹ The Sterling Area at that time comprised the British Empire, less Canada and Newfoundland, and one or two countries such as Egypt and Iraq whose currency was 'tied' to sterling.

the material. The problem, perhaps otherwise insoluble without the creation of a special staff, was solved by an ingenious scheme whereby coupons were paid into banks in certain agreed quantities and cleared by an adaptation of the existing machinery for cheque-clearing.

All this extra work, and much of it was highly skilled, had to be carried out by a staff which was being rapidly depleted by the demands of the Forces. The fine reputation for voluntary service established by bank clerks in the First World War was strikingly enhanced in August 1939 when the Territorials were mobilized and literally thousands left our banks to join their regiments. Upon this early loss there was superimposed that caused by the routine working of the Conscription Acts during the next six years, so that by the time victory came there were few if any men of under forty left at the desk. Of the staff who remained, the great majority had hastened into the various branches of civil defence, and in the London area long days of work were all too often followed by nights of trying and sometimes dangerous service.

The banks met the strain on their manpower in more than one way. During the two decades before the war, two or three of them had been engaged in very extensive (and expensive) branch opening, and all of them had expanded their branch network considerably. The shortage of staff led to an abrupt reversal of this movement. The more unprofitable offices were closed down, war damage shut up others, and one bank actually reduced the number of its branches and sub-branches by 20 per cent. A second expedient was found in the simplification of administration, and here also a certain amount of good came out of evil. Every large concern is liable to the

danger of over-centralization, and to the making of returns to headquarters there is no end unless some great shock forces an overhaul of the system. With the banks, much useful work was cut down temporarily, such as the frequent inspection of branches, but the opportunity was also taken to discontinue all sorts of small tasks whose utility had long ceased to be obvious. The most important contribution to the solution of the problem lay, as with so many other industries and trades, in the increased recruitment of women. Except possibly for a stray typist or two, British banks had employed none but men before 1915 and they would doubtless have continued with all-male staffs for many years but for the economic impact of the first war. Women were then taken on not only to act as shorthand-typists but also as clerks and, when 1918 came, many of them stayed on. Nevertheless, they never achieved equality of status; a woman employed in one of our banks, be she ever so able, cannot climb past a certain rung in the ladder of preferment in the way that is possible in a few United States banks. In spite of this limitation there was never any difficulty in enlisting female staff to replace and supplement the first wave, for continuity of employment and an assured pension have their attraction, but when the second great man-eating war came the rate of intake rose so rapidly that by its end men and women were employed by banks in almost equal numbers.

One labour-saving device was not pushed much further. The Machine, which has increasingly dominated industrial processes for the past century and a half, made a belated and timid entrance into general banking as one of the results of the depression of the thirties. The typewriter, most innocent of aids, was unknown in the

majority of branches as late as 1914 and, outside the large central offices, adding machines were regarded as enervating luxuries as recently as twenty years ago. It was therefore unlikely that the complicated mechanisms associated with machine accountancy would receive an early welcome, and any future economic historian who seeks to discover the pioneers of this branch of progress must look elsewhere than the banks. But the pressure of reduced earnings and diminishing profits is a salutary if unwelcome teacher and the banks were not above learning, so that to-day each of them has its carefully chosen machine staff and its preparatory school for training all new entrants in the intricacies of mechanized accounting. Banks are not factories, however. The role of automatic processes is subject to fairly definite limits and their organization makes heavy calls on expert supervisors; those limits, and the shortage of highly-trained 'foremen', explain why banking by conveyor belt was not one of the fruits of wartime enterprise.

Among the many plans based on the assumption of destruction by enemy action and on the possibility of invasion, there were two specifically connected with the business of banking. The bankers' clearing house departed from Lombard Street and took up wartime quarters in the Midlands, thereby causing considerable delay in the collection of the vast stream of cheques that pours daily in and out of its doors. The need of putting the second plan into action was obviated by the victory won in the Battle of Britain. It had been designed to enable banking to be carried on in Free Britain should some part of our island fall into enemy hands and it provided for a set of regional controls each of which would be fully equipped to work independently of the

rest. Perhaps it is as well for the plan that it was never tested; if the experience of other countries be a guide, we may venture a guess that had the Germans made a successful landing they would very soon have engulfed the evacuated clearing house, water-tight banking areas and all.

For some months before the Allies' final offensive opened in Normandy, the financial representatives of the United Nations held many meetings to hammer out plans for the resumption of international trade, and within each country national governments started to take stock of their losses and their assets. For Great Britain, with her need of large-scale imports, there could be no satisfactory outcome that did not include a stable world across whose seas cargoes could move in peace and be paid for through a smooth-running exchange mechanism. In our banks, the departments specially concerned with foreign business had seen their staffs drastically cut down as market after market was shut off by the events of the war. To them peace meant a return to productive activity and the minds of the older men went back to the hectic and highly profitable days of 1919-20, when, with Government controls thrown off as one throws off a stifling blanket, Britain sprang into the struggle of world trade full of zest and hope. Alas, things have worked out differently this time; indeed, they were bound to do so, for there was little analogy between the second war against Germany and the first. In 1945 the Britain that emerged was much wearier, much poorer, and much more battered; but although the interval that has followed the enemy's surrender has been one full of painful readjustments delayed by frustrated expectations, the country's banking system has managed to settle down

to its new tasks remarkably well. Great bodies of ex-Service men have been re-absorbed, large numbers of women have left to marry or to engage in other occupations; yet with it all the rhythm and routine of banking appears very like what it was before the bombardment.

Nevertheless, big changes have occurred. Because banks deal in money, any large alteration in the quantity of money must affect their activities closely. A country waging a war has got to pay for it and payment is made in various ways. One of them will almost certainly be through the issue of additional paper money which finds its way into the pockets and bank accounts of the people. The goods which this money in the first place calls into existence are mainly armaments required by the Government, armaments which are used up in the purely negative task of war, so that when the bombs have been dropped and the tanks smashed we come to a state of affairs where there is plenty of money but a very small volume of corresponding real things.

The figures of the note-issue and bank deposits during the years from 1939 to 1945 illustrate how the war effort was partially paid for by the direct action of the Government in turning on the printing press and by expanding credit:

(In £ million)

	August 1939	Average, 1940	Average, 1942	Average, 1944	Average, 1945
Notes in circulation . . .	508	575	808	1,136	1,284
Clearing banks' deposits . . .	2,245	2,506	3,275	4,153	4,692
Savings banks' deposits . . .	—	928	1,388	2,024	2,381

The use made of the greatly increased volume of deposits may be seen from a glance at the assets side of the clearing banks' balance sheets:

PERCENTAGE USE OF DEPOSITS

	August 1939	Average, 1940	Average, 1942	Average, 1944	Average, 1945
Advances . . .	43.9	38.1	24.3	18.1	16.3
Investments . . .	26.7	26.6	32.7	28.0	24.6
Treasury Deposit					
Receipts . . .	—	2.9	19.6	33.4	38.6
Bills discounted	12.4	14.7	7.2	4.1	4.0

This table shows that the proportion of deposits employed by the banks in loans and overdrafts fell steeply as the war progressed, thus resuming the trend already evident during the earlier years of slump. The need for industrial bank credit, which one might have expected to have become active under conditions of rising munitions production, was in fact much diminished by the system of progress payments from Government departments. New advances to our revived agriculture were probably more than offset by repayments of long-standing pre-war debts; and, as has already been mentioned, advances to non-commercial customers were discouraged by the authorities. Discounts, also, fell away, for fewer and fewer bills of exchange reached the market as the financing of imports and exports passed more and more into the hands of the various ministries.

An outlet for the expanding volume of funds was found in further investment in Government securities, but the greater part of the increased deposits made its way into the short-term paper bearing the name of

Treasury Deposit Receipts. These receipts were made available only to banks. Their issue commenced in 1940 and they earned a mere $1\frac{1}{2}$ per cent. per annum (and, later, only five-eighths), so that the income to be derived from them was negligible unless a large quantity was held. Even with something like £1,800 million (1945) utilized in this fashion the clearing banks felt the drop in earnings caused by the loss of the more remunerative advances of former days, and adversity brought them together under the friendly auspices of the Treasury in an agreement to refrain from paying interest on any current account and to give a maximum rate of only half of 1 per cent. per annum on all moneys left with them on deposit account. Cartel agreements of this type had been common enough on the Continent for many years, but banks in this country had hitherto restrained from going beyond the informal gentlemen's agreement, and it is doubtful whether any united front would have been presented had not the Government, for its own purpose, seen fit to interpose.

The effect of the war on the money market passed, of course, beyond the banks' problems as to the utilization of their deposits. Though the clearing banks are the largest members of the market they are by no means the only ones, and the good or evil fortune of the lesser brethren is a matter of importance to the whole financial community. The most important market companions of the banks are the 'discount houses', known collectively as the discount market, whose business is (or rather was) that of mobilizing the most liquid resources of the banks in order to finance the movement of goods by the discounting of commercial bills of exchange. Prior to 1914, the good billbroker was one possessing an encyclopaedic

knowledge of traders and their reputations and he was accordingly able to distinguish between good bills and bad, between genuine trade bills and those bills known as 'kites', which were let loose on the world without a proper backing of goods. The billbrokers borrowed at low rates from the joint-stock banks and used the money to discount good bills, and these in turn served as security for further borrowings. The bills were arranged in the order of the dates on which they fell due for payment, so that the brokers' (and bankers') money turned over with an even rhythm, except that the country's demands for primary products such as cotton, tobacco, tea, and rubber created seasonal bulges.

In those days the Treasury bill, though it had been in use for a generation, accounted for but a tiny portion of the market's stock in trade; but for the reasons already mentioned the commercial bill was doomed. The war of 1914-18 brought about a plentiful issue of Treasury paper concurrently with a diminution of trade paper so that the look of the billbroker's portfolio suffered a drastic change. This undesirable trend was reversed during the nineteen-twenties; but even in the boom year of 1929 the total of commercial bills was still less than in 1913 in spite of the rise in prices, and the following decade, which witnessed the collapse of multilateral trade between nations, saw also the virtual disappearance of the ideal international credit instrument. In these circumstances the billbroker would have gone the way of the arrow-maker and handloom weaver of previous ages had it not been for the Treasury bill, now become a regular part of Government money-raising. Unfortunately, dealing in these bills was not only a dull mechanical task but also it showed little profit and the discount

market had to seek another source of income. This was found in high-class bonds and Government securities of various types. The banks, and the Bank of England, believed strongly that it was a good thing to maintain the London custom by which the banks never borrow directly from the central bank but leave the short loan market to be formed by the borrowings of the intermediary billbrokers. The crisis in billbroking forced the banks to act on their belief and to keep the broking firms alive by low lending rates against deposits of Treasury bills and, later, against Government and other high-class bonds. Even this aid would not have sufficed (except in the case of the 'Big Three'¹ of the discount market) but for the sudden alteration in conditions which took place during the Second World War and completely changed the monetary outlook. The decision of the Government to borrow on a very large scale by the issue of short term bonds (£2,000 million was issued within three years) brought into the market far more securities of this type than could be comfortably handled through the Stock Exchange, and the machinery provided by the discount houses was utilized to carry the added load. The greater part of the bonds taken up by the market was financed by means of borrowing from the banks, but even so the Treasury wisely encouraged amalgamations and increases of capital, with the result that the number of discount houses fell from eighteen in 1939 to eleven, while the capital was increased from about £20 million to £22 million in 1945. The great burden of the national debt made it a matter of prime importance to the Government to keep down the rate of interest. This

¹ Alexander's Discount Co. Ltd., Union Discount Co. Ltd., National Discount Co. Ltd.

could not be done without the enforcing of a stringent control over the money market, and the discount houses owe their resurrection to their usefulness as instruments of control. So the most keenly enterprising section of the City has lived to see itself turned into a piece of skilful mechanism fed in jerks and spasms by an almighty Treasury.

CHAPTER 5

THE FAMILY OF BANKS

THE BIG FIVE so dominate the eye as it travels along the main streets of our great cities that something of an effort is needed to recall that the British Bankers' Association has a membership of some sixty institutions. The majority of these have one London office only, and any branches they possess are usually outside England. They divide themselves into various groups and within each group there is to be found a considerable variety in size. The multiplicity of their activities inevitably gives rise to the question—what is a bank?

A learned lawyer once said that though the concept of Negligence was fundamental to the whole of our massive law of Contract, yet there was only one statutory definition of it—where the Book of Common Prayer states that we have done those things we ought not to have done and have left undone those things we ought to have done. In our country a bank is in much the same undefined condition; we are all fairly sure what it is but the law is satisfied with announcing that a bank is a concern engaged in the business of banking; beyond that, the community is very sensibly left to puzzle over or to ignore the problem. A bank's services have become so wide with the passage of time that it is perhaps sufficient to say that a bank is a business that accepts deposits and undertakes to repay the depositors on demand being made by them in writing. From this description it will be clear that banks are not primarily lenders of money

or takers of pledges, as are moneylenders proper and pawnbrokers, and Parliament has recognized this by making laws which, though they regulate the day-to-day activities of the latter trades, leave untouched the operations of the banker.

The banks having offices in London bear witness in their variety to the City's traditional hospitality. Before two great wars diminished the community of civilized mankind, the number of foreign concerns established in our island was even greater, and long before the League of Nations set up its headquarters by the Lake of Geneva there existed a far more amicable adumbration of it on the banks of the Thames. Of the English banks other than the eleven clearing banks, the most interesting are the merchant banks and finance houses. They are distinguished by their participation in various activities usually left alone by the ordinary bank but a great part of their work covers the same ground. Some of them have a direct interest in commodity dealings, or have trading subsidiaries; others specialize in the flotation and management of great issues of bonds put out by foreign governments or foreign railways. We have spoken of them as English and, indeed, the annals of Parliament and the wider records of British history are frequently marked by the names of the leading merchant banking families; yet most of the merchant banks were founded and made great by men who first came into our midst as foreign strangers. It is among these houses that we find several of the outstanding Jewish names. Here, and not among the makers of the Big Five, is where we must look for Rothschild, Montagu, and Sassoon.

So much mystery and prejudice has gathered round the Jew as financier that it is not out of place to look at

his activities as exemplified in the story of the three families just mentioned. First in importance is N. M. Rothschild and Sons, whose Red Shield hangs out over the narrow thoroughfare of St. Swithin's Lane. Nathan Rothschild came to England from Frankfurt-on-Main in 1797 and by 1805 he and his brother had firmly established themselves as foreign exchange dealers. The interest aroused by their career is illustrated by the host of vivid if occasionally apocryphal stories handed down regarding them, but the rapidity of their rise bore witness quite as much to the kindness of the climate to which they had transplanted themselves as to their native ability. Other branches of the family thrust out to Paris and Vienna, so that by the middle of the century the House of Rothschild was playing an important part in the financial mechanism of at least four European states. Nor was Europe the limit of their ventures. The London firm, for example, took a lead in floating sterling loans on behalf of the young Latin American republics and to this day Rothschilds are the principal paying agents for the interest on Brazil's external bonds. To this type of work there was added the dealing in and refining of the precious metals; but it is impossible to speak with any certainty of the range of Rothschild activities, for the business has retained its early partnership form and little or nothing is known precisely as to its widespread enterprises. A guess may nevertheless be hazarded that the destruction of the German and Austrian cousins and the breakdown of the commercial Concert of Europe must have meant a restriction of many sides of the London house's business. The issue of foreign loans has also died away in recent years and many of the old loans are in default with the result that no interest on them is

remit ted for distribution. Yet in spite of all this, Rothschild is still much more than the shadow of a great name and its titled holders retain much of the importance which belonged to Lionel Nathan Rothschild, the first Jew to take his seat in the House of Commons.

The Sassoons came to London by a very roundabout route. Hundreds of years ago they lived in Spain, though little is known of their early history. Persecution drove them to Baghdad in the sixteenth century and there they flourished for some two hundred years. Once again oppression led to a search for more tolerant surroundings and finally, in 1832, David Sassoon settled in Bombay. His skill and energy established his firm's business all over Asia and the next generation set out to build up a stronghold in London. A Sassoon founded the Eastern Bank, which has played a worthy part in the development of Iraq, but the family is chiefly associated by the City with the E. D. Sassoon Banking Company. This bank has its head office in Hong Kong but conducts a large and varied merchant banking business in London, being helped by its innumerable family ramifications in much the same way as were the Rothschilds in Victorian days.

In the year that David Sassoon went to Bombay there was born in Liverpool one Montagu Samuel, the son of a small tradesman. His names were early changed round and it was as Samuel Montagu that he came to London at the age of seventeen. He soon showed exceptional ability in money-changing, the collection of foreign coupons and other such subsidiary banking operations, but the firm of Samuel Montagu & Co., founded in 1862, was not long satisfied with this limited range. Exchange business was developed on a large scale and to it was

added the gold and silver bullion dealing that plays such an important part in this wealthy concern's activities to-day.

It is typical of the Jewish outlook that the leaders of their great financial families have never been content to limit their public life to their business interests. Music, politics, and philanthropy have all been enriched by their many-sided interest in mankind, and if England has provided them with the field whence they extracted much of their wealth they in turn have often given her as true a devotion as have the sons of her native stock.

An important section of the banking community is that comprised by the Dominion and Colonial banks. We have already noticed one of the most important when we were dealing with the overseas interests of Barclays Bank but the majority of the group consists of independent institutions. Pride of place may be accorded to what are known as the Eastern Exchange Banks. Two, the Hongkong and Shanghai Banking Corporation, and the Chartered Bank of India, Australia and China, possess a branch system reaching from Bombay to Tokyo; while the National Bank of India and the Mercantile Bank mainly occupy themselves with India. The Imperial Bank, the agent of the Reserve Bank, is the heir of the old 'Presidency' banks and occupies a quasi-official position but may for convenience be bracketed with the other Eastern Banks.

These banks have long dominated the commercial banking side of India, Burma, and Malaya, and the first two have played a prominent part in the development of China, Siam, and the Netherlands East Indies. During the recent war a large number of their branches east of Calcutta came under enemy control and since the

defeat of Japan the troubled state of Java and China has prevented a resumption of normal trading; and in every eastern country the forces making for self-government are creating serious problems for business concerns owned and directed by Europeans. It is too soon to predict the ousting of the Eastern Banks from their commanding position, for they possess large resources, long experience, and a high reputation, but it is impossible not to reflect how nations newly come to independence are prone to indulge in a shortsighted xenophobia that cares little for either self-interest or justice.

A group with many doubts about the future is the one made up of the Australasian banks. Some of them confine themselves to one or other of the two Dominions, some have branches in both. Those established in Australia face the competition of the Federal-owned Commonwealth Bank and have recently had to work within a rigid framework of Federal regulation. Up to now, however, all have shared in the great wave of prosperity which has carried an already generous standard of living to new heights, but it looks as if the Australian Federal Government is determined to nationalize banking entirely. The issue is being fought out fiercely, for with this service the consumers (that is, the people with bank accounts) are in the main eager to support the resistance put up by the existing owners and managements. As long as there are several banks, a dissatisfied depositor can shift his account, and this right constitutes a salutary check on inefficiency, a check welcomed quite as much by banker as by customer.

There are at least seven prominent Australasian banks. Rhodesia and the Union of South Africa are satisfied with three, although in the past there were several com-

peting concerns. Besides Barclays (Dominion, Colonial & Overseas), which took over the National Bank of South Africa, there is the Standard Bank, whose outstanding position from Cape Town to the Congo border is generally recognized, and the Netherlands Bank for South Africa, reminding us by its title of the original white settlers and the empire that Holland lost.

Canada, the richest of the Dominions, is represented in London by three banks of great size—the Royal Bank, the Bank of Montreal, and the Canadian Bank of Commerce. Their numerous branches are scattered across the three thousand miles of land dividing Atlantic from Pacific. The immense economic strides taken by Canada in the past thirty years are but a beginning and the next generation may see these three banks taking their places among the largest in the world.

Before we leave these Dominion banks it is worth remembering that they are, in general, the fruit of Scottish enterprise. The original impetus came from Scotland partly because the excellent Scottish educational system created more intelligent literates than local commerce could absorb and partly because Scotland, as has already been pointed out, developed branch banking at a time when England was still enjoying an anarchy of small private banks. The early link has never been snapped, so that anyone who to-day enters one of the Eastern Exchange Banks will as like as not be greeted in the warm accents of Edinburgh or the Western Isles.

The foreign-owned banks in our midst have been reduced in number by two wars and by the contraction in international trade. No longer can one see the London office of some great German institution, the Yokohama

Specie Bank has vanished from Bishopsgate, and the diminished importance of Chile was witnessed some years ago by the shutting down of the Banco de Chile's branch in Gracechurch Street. The City still draws the world, however, and fresh arrivals go some way to fill the gaps. Several American banks have London offices, while others employ representatives whose duty it is to watch over the British interests of the parent body. In France, the leading banks have recently been nationalized, but the Crédit Lyonnais and the Société Générale still do a vigorous London business. Belgium, Portugal, Holland, and Czechoslovakia all have a foothold here, and Italian banks are busy forging afresh the links that were snapped when Mussolini came into the war. The indigenous banks of the East have found it worth while to come to England; the Bank of China, the Reserve Bank of India, the Bank of India—these and others are here, bearing witness to the force of change and progress in distant lands. All are welcome; British bankers, true to their well-tried traditions, accord equality of treatment to every newcomer provided he adheres to the standards of business conduct hammered out through years of honourable dealing.

In this review of all the different kinds of bank there remain to be considered those savings institutions which might be, but are not, called People's Banks. Outstanding among these is the Post Office Savings Bank. It was founded when Gladstone was Chancellor of the Exchequer in 1861 and to-day the credit balances of its 21,000,000 depositors total £1,800 million and the bank holds over a thousand million pounds' worth of war stock representing further saving by the people. Wisely, perhaps, the P.O.S.B. has refrained from widening its

scope to embrace normal banking operations. No depositor can draw a cheque on his account, nor can he avail himself of a *giro* transfer system such as is available in some continental countries. On the other hand, the bank pays interest at $2\frac{1}{2}$ per cent. on deposits, a very high rate in these days.

The inception of a state savings bank was regarded with hostility by the Trustee Savings Banks, the pioneers of popular thrift. The first of these banks may be said to date from 1799, when the parish priest of a small country town announced that he would receive from his congregation any sum from twopence upwards to be returned at Christmas with one-third of the whole added as interest. It was an age of numerous benevolent enterprises, and other public-spirited venturers were quick to set up 'charitable banks' and 'provident institutions' of a like nature. As might be expected, the movement attained great importance among the thrifty Scots. It was there that savings banks were first established on a proper basis through the planned investment of the deposits in fixed-interest-bearing securities, and so successful were the altruistic promoters that they felt justified in securing a measure of state protection for their promising offspring. This was obtained by the Act of 1817, which fixed generally the form and conditions of the Trustee Savings Bank system as it exists to-day. Subsequent Acts have made additions and variations, but the salient points remain: trustees and managers are forbidden to make a profit for themselves; they must pay over ordinary deposits to the National Debt Commissioners, who invest them in state securities; the Commissioners pay interest to the trustees at a fixed rate on the cash so paid over and are bound to return the cash

to the trustees pound for pound when required to do so. Under a later Act, depositors were given a right to deposit their money in what are known as special investment departments, and this money (which carries a higher rate than ordinary deposits) is largely used in loans to local authorities. At the close of 1945 total balances inclusive of Government stock held for depositors amounted to over £674 million and the combined surplus funds to nearly £16 million. The Trustee Savings Banks are linked together through an association formed sixty years ago and endowed with various co-ordinating powers. This association has been outstanding in its support of the various savings campaigns designed to attract the surplus money of the 'small man', and during the Second World War the special investment departments put £28 million in new issues of Government stock and sold £90 million of stock and savings certificates to depositors. Deposits are received in the ordinary department up to a maximum of £2,000 for any one person, subject to an annual limit of £500, and interest is paid at $2\frac{1}{2}$ per cent. Thus far Trustee Savings Banks resemble the P.O.S.B. but many of them will also undertake the safe custody of securities and valuables, and there are other facilities whereby depositors can pay their local rates and lighting bills through their bank. Nevertheless, the range of services is limited by law to something far less than that obtainable from the ordinary commercial bank; there is no drawing of cheques, no granting of advances, and no fruitful discussion of the pros and cons of some business venture.

Each Trustee Savings Bank has its headquarters in some important town and its branches are found both in the local suburbs and the neighbouring towns. The

Aberdeen Savings Bank, for instance, one of the largest, has forty branches, over thirty of them outside the city itself; yet although these banks are all named after the places where they have their head offices, none of them is owned by a municipal authority. It is a curious thing that in a country where many provincial towns have had a long and important history and civic pride has blossomed freely in art galleries and universities, only one city has been alive to the advantages of municipal banking. That city is Birmingham, and its bank is the result of the energy and influence of Neville Chamberlain, once Lord Mayor of Birmingham and later Prime Minister of Britain.

Even if we allow for Chamberlain's enthusiasm, it is doubtful whether the bank would have been founded but for the accident that there was no Trustee Savings Bank in Birmingham. The story starts in 1915, when money was urgently needed for war. The Lord Mayor felt that the most convenient and popular channel for collecting small savings would be formed by a municipal bank. Plans were drafted, and finally approved the following year when parliamentary powers were obtained by the passing of the Municipal Savings Banks (War Loan Investment) Act. It was a grudging, ungenerous measure, limited to local authorities having a population of 250,000 or over. Its very title declared that such banks were to be regarded as temporary wartime affairs and one clause expressly limited their life to a period ending three months after the termination of the war. Deposits could be accepted only from employed persons by deduction from their wages, or by some similar arrangement. The maximum balance of any depositor was not to exceed £200 and withdrawals on demand were limited

to £1 at a time. In these circumstances it is not surprising that Birmingham proved to be the only city willing to establish a municipal bank, and had it not been for Neville Chamberlain's patient optimism there might not have been this solitary child of the Act. The bank's early days provided ample proof of its utility in spite of the clumsy shackles that bound it; in fact, it did so well that the limited authority by which it was created was enlarged by certain provisions in the Birmingham Corporation Act of 1919.

During the years since it was set on a permanent footing, the Birmingham Municipal Bank has flourished and to-day, besides its handsome head office, it possesses several branches in the neighbourhood. By 31 March 1946 there were nearly 600,000 accounts, with balances totalling over £74 million. The house purchase department, an interesting and important feature of the bank's work, had at the same date outstanding advances of £8,382,000, made to 20,767 mortgagors. Twenty years earlier these loans only amounted to £1½ million, while total savings deposits were under £7 million. One cannot imagine Neville Chamberlain being happy in revisiting the scenes of many of his lifetime's activities, but his returning ghost would have a right to feel pleased could it survey the bank which his zeal has so firmly established for the use of his fellow citizens.

The municipal nature of the B.M.B. makes it natural that it should sponsor savings clubs in the municipal schools and it is also natural that many of the children, familiar with *their* bank, should in due course become depositors. But as any losses incurred by a municipal bank necessarily fall on the ratepayers, losses must not be made. So the dangerous jobs have to be left to the

commercial banks, who by their constitution have to bear their losses themselves as best they can.

Another savings bank, which demands notice both because of its size and its social interest, is the one founded by the Co-operative Movement. The Co-operative Wholesale Society Bank is constituted as a department of the Co-operative Wholesale Society Ltd., which in turn is a federation of retail and other distributive co-operative societies in England, Wales, and Northern Ireland. The bank's profits are not distributed to shareholders in the form of dividends but serve to supplement the rates of interest paid on credit accounts and to lower the rates charged on debit accounts. There are only about eight proper branch offices, as reliance is mainly placed on the 2,500 banking points provided by the shops of the retail co-operative societies. In addition to the accounts of individuals there are those of the various member societies, of trade unions, and of local authorities. During the past year or two these last have assumed great importance, several boroughs having transferred their funds from the joint-stock banks to the 'Co-op'.

The balance sheet issued in January 1947 shows current accounts at £37 million and deposit accounts at £212 million. Judged on these figures, the C.W.S. Bank is larger than such sizeable clearing banks as Martin's or the District, and about a third the size of the Westminster Bank, which acts as its clearing agent in London. The very high proportion borne by interest-bearing deposit accounts to current accounts marks it, however, as being different in kind from the commercial banks and the assets side of its balance sheet is rather like a savings bank's. Advances, for example, account for a mere 2 per cent. of total assets, while investments in securities (all

very sound) amount to over 90 per cent. as against a corresponding 25 per cent. for the clearing banks. From this it follows that the C.W.S. Bank does not enjoy the doubtful pleasure of holding a substantial part of its funds in low-yielding Treasury Deposit Receipts as the ordinary bank is virtually bound to do. The result of this and of the high proportion of assets invested in better-yielding securities is that the C.W.S. Bank is able to offer attractive rates to deposit account holders—hence the recent transfer to it of municipal funds. The price paid for this structure is what is known as lack of liquidity: whereas a joint-stock bank's 'cash in hand and balances at the Bank of England' uses up 8 per cent. of its assets, 'bank balances and cash in hand' accounts for only 0.8 per cent. of the assets of the C.W.S. Bank; but this probably does not matter very much to a concern which functions mainly as a savings bank.

The Co-operative Movement is closely linked to the Labour Party and its bank is consequently the object of a certain amount of political suspicion by anti-socialists, who fear that a Labour Government may feel inclined to give it advantages, if only indirectly. This anxiety may be entirely without foundation, but the C.W.S. Bank doubtless draws a measure of strength from the fervour of convinced co-operators and it is proving politically as well as financially attractive to socialist town councils having large sums of money to leave on deposit. What shopkeeper ratepayers, who have to compete with the local co-operative stores, think of this manner of banking their contributions to local expenses is another matter and need not be entered into here.

CHAPTER 6

THE BANK OF ENGLAND FROM THE NORMAN ERA TO NATIONALIZATION

THE FIRST WORLD WAR changed many things, but to the casual observer it did not seem to bring any alteration to the Bank of England. City clerks, returning from their service in the Forces, were met by the reassuring presence of the same building that they and their fathers had known, the eighteenth-century creation of Sir John Soane, occupying its splendid island site of nearly four acres. There were unkind critics who maintained that the windowless exterior walls were symbolical of a Court of Directors that neither desired to look on the world nor be looked at by it; but the nation as a whole was content to ignore the jibes and denunciations of monetary reformers and to satisfy itself with the comfortable warmth of the time-honoured phrase—‘safe as the Bank of England’.

In some ways, indeed, the conduct of affairs within the walls was as little changed as the walls themselves. The outsider who entered the main door in Threadneedle Street, even if he were engaged on a legitimate errand, still felt small and strange as the impressive uniformed guardian descended upon him to learn his business. There was still the feeling that here was no ordinary bank, but a temple devoted to a mysterious if beneficent cult.

Several circumstances conspired to strengthen the awe-

someness of the Bank, and they might be summed up collectively in the word 'unchanging'. Every week within the memory of the oldest customer, the Bank Return had appeared as prescribed by Peel's Act of 1844, neatly divided between the Issue and Banking Departments. For longer still, the Court had maintained its close corporative structure, independent of Government or Parliament. All the directors were elected from among the merchant bankers and the same family names and business interests appeared over and over again as generation succeeded generation. But though the Court was drawn from a narrow circle, the oligarchs practised a republican egalitarianism among themselves. Each director in turn became deputy-governor for two years and was then elected governor for the following two years. Whether the honoured man was fit to hold these offices was never considered except by inquiring outsiders such as Walter Bagehot, the famous Victorian editor of *The Economist*, and the system had at least the great advantage of rendering pointless any jealous striving for the first place. The tradition of City gentlemen giving up some hours of their time each week to the conduct of the Bank's affairs had reality, for the ordinary directors retained their partnerships in their various firms, and when the governors stepped down from 'the Chair' they resumed their work as private bankers. The Bank prospered under this form of direction prior to 1914 because it was served by an able succession of senior clerks who had hammered out over the years a set of rules for working the gold standard. The mechanism devised was delicate, but its simplicity may be gauged by the fact that the central monetary institution of the world's greatest commercial State had no special

foreign exchange department and no formal statistical service.

The four years of war greatly impoverished the country through the sale of our foreign investments and through the incurring of a heavy debt to the United States. We were still *de jure* on the gold standard but *de facto* we were on a paper standard whose shaky foundation was utterly repugnant both to the Government and to the banking community. The abnormal pressure of war conditions led to one important change at the Bank: Lord Cunliffe, the governor, remained in the Chair throughout, and the deputy-governor also retained his office. Lord Cunliffe died in 1920 and thus, by accident so to speak, there rose to the Chair the man whose name and policies came to be closely bound up with Europe's history for nearly twenty-five years. Montagu Collet Norman was at that time still under fifty. A partner in the conservative banking house of Brown Shipley & Co. since 1900, he had enjoyed a period of useful experience with his firm's American associates and had been a director of the Bank for thirteen years. On both sides of his family he descended from men who had been members of the Court for long periods in the preceding century. In spite of the almost exaggerated respectability of his surroundings and upbringing he stood out as one of the few picturesque figures of modern times. He was also endowed to an exceptional degree with tenacity, adroitness, and charm.

The desired return to an international gold standard demanded, as a first step, the rehabilitation of the nations broken by the war. Montagu Norman bent his great powers to secure the restoration to solvency of friend and foe alike and by 1926 he had achieved his aim in spite of

the constant hostility with which his various moves were greeted. To him, a re-establishment of the Central European economy constituted the logical basis of world recovery and he was fortunate in finding a steady ally in Benjamin Strong, the Governor of the Federal Reserve Bank in the United States. He achieved his object by several parallel moves: the Bank of England granted direct credits to a number of central banks pending the conclusion of international stabilization loans through the League of Nations; from behind the scenes he encouraged the League to speed up and widen its constructive measures; and he worked ceaselessly to secure co-operation between the various central banks. The aim throughout was to restore to Europe a pattern of stable currencies and it was no accident that the methods chosen helped also to restore stable living conditions for ordinary people.

Forty years ago it would not have been easy to write a reliable book on the principles of central banking. Most civilized countries at that time had a bank which acted more or less as the Bank of England did in the United Kingdom and there was a voluminous literature on monetary policy, but little or nothing was thought or said about the working rules that should govern the activities of a pivotal bank. The result was that a large number of central banks grew up in a haphazard fashion, each subject to statutes deriving from its own particular circumstances and bound by customs and traditions reaching back to a time when conditions were different. The First World War put an end to many of these home-made systems, and the breakdown of the gold standard, though it created fresh difficulties, created a situation where the scope of co-operative action was widened.

The Bank of England, as the central bank of the least damaged among the principal European belligerents, threw all its influence into the scales to secure as much uniformity as possible between the statutes of the various reorganized or newly-founded institutions, but there does not seem to have been any attempt to impose the British structure on other countries—none of the continental banks, for instance, adopted our division between the issue and the banking departments. The similarities sought concerned such points as freedom from Government interference, avoidance of competition with commercial banks and, above all, the creation of a co-operative state of mind among the various directing bodies so as to establish a kind of international club whose members were fitted by temperament and experience to check the excesses of narrow nationalism.

Mutual aid between central banks in times of emergency was no novelty even before 1914, but there had been little need for day-to-day liaison in a world made safe for stability by the gold standard. When most countries resumed working under the rules of that standard, from 1925 onwards, the old certainty had gone, for the world found its doubtful equilibrium constantly threatened from all directions. The principal danger arose from what was itself a symptom of distrust—the scramble for gold. Montagu Norman was indefatigable in devising methods by which the available stock of the precious metal should be made to suffice for the performance of its functions of settling differences in balances of payments and of giving the ordinary man confidence in the stability of his own money, but the attempt to secure agreement on gold policy broke down in the face of French intransigence. The story of that long contest to create an

international mind, though not of a nature to interest the general public, deserves careful study by bankers to-day, when the world is once more seeking to discover an expression of its basic economic oneness, and the International Bank for Reconstruction recently set up at Washington might do worse than hang in its council chamber a portrait of the man who more than any other strove to create monetary conditions in which men might live freely and in peace.

One result of Montagu Norman's policy was the establishment of the Bank for International Settlements. Its functions included the difficult task of facilitating the transfer of Germany's war debt payments, but historians may well conclude that its major achievement was the stimulation of co-operation between central bankers, for its directors were appointed by its central-bank members and not by political States. The wide possibilities of the B.I.S. were, however, still little more than becoming half-understood when the rise of Nazi Germany, coinciding as it did with the breakdown of multilateral trading, struck a fatal blow at all organs of international co-operation so that the new institution lost ground and its purposes narrowed. The outbreak of war in 1939 virtually put the B.I.S. into cold storage and though it still exists, and has a splendid statistical department, it seems fated to lose its identity in the wider organizations planned by the United Nations.

Britain's enforced abandonment of the gold standard in September 1931 ushered in a period of 'managed money', a period in which we are still living. The management was in the hands of the Treasury and the Bank of England and in its earlier stages was necessarily empiric, but the basic feature was that the volume of

national currency and credit was determined by the authorities' views as to the nation's requirements. The pound's external value depended on the interplay of supply and demand for sterling, except that it was possible to even out temporary fluctuations by using the funds in the Exchange Equalization Account, which became an important holder of gold and foreign currencies. A large number of countries followed our example in 'coming off gold' and most of them linked their moneys to sterling. This led to the informal creation of what came to be known as the 'sterling area', which soon fashioned working understandings with countries still on the gold standard, such as the United States and France.

In the development of the financial techniques best fitted to deal with the changed circumstances the Bank of England played a big part but, as one looks back, the 'management' of credit and currency between 1931 and 1939 has a half-hearted look about it and the managers have the appearance of men whose minds were still overshadowed by ideas incompatible with the measures called for by the new needs. Under the aegis of the Treasury and the Bank these years formed an era of cheap money. Interest rates were lower than they had been for thirty years, with bank rate maintained at 2 per cent. and with the Government borrowing on short term at 1 per cent. or less. Somehow or other, however, the benefits of cheap money spread themselves in a very uneven manner. The Government was able to finance itself cheaply but it formed a habit of requesting other borrowers to keep out of the market when its own loan operations were on foot. In spite of the astonishing way Britain recovered her standing after the first critical weeks following the departure from gold, there never developed that

climate of hope without which recovery cannot proceed very far—and from 1933 onward the gathering war clouds were sufficient to darken the timid sunshine that was all that our system of management was able to create.

The numerous changes and experiments which took place after the departure from gold brought misfortune to many industrial regions, but the grim picture of the depressed areas was partly hidden from City eyes by the solid solvency of the country's financial institutions. One might say that it was hidden by the great rebuilding of the Bank of England, which took place about this time. The architect's design was a daring one—to superimpose on Soane's two-hundred-year-old structure a great modern block of masonry rising to twice the height of the original building. Year after year the massive pile was raised higher and spread its bulk across fresh stretches of the ancient roof until the hybrid stood complete, a symbol of powerful traditions in alliance with the steel and concrete forces of a new age.

Perhaps the most important long-term consequences of the seven years of managed money that preceded the outbreak of war were the drawing together of the two managing organs until they sometimes became indistinguishable in their action, and the increasing control that they grew to exercise over the money market. The wishes of the Government came not only to be expressed with greater frequency but were also heeded with a humility that would have shocked an earlier generation brought up to believe in the inherently evil nature of State interference. It is impossible for the outsider to say how far Montagu Norman himself was a willing party to these great changes: perhaps the changes were unavoid-

able and he, like a good business man, made the best of the inevitable.

There were two things that greatly facilitated the linking together of the Treasury and the Bank. The first was the repeated re-election of Norman to the governorship: this made it certain that both bodies were in the charge of permanent chiefs who, if they happened to see eye to eye, could jointly exercise an unquestioned power. Within the Bank itself, the growing hold of the governor owed something to the fact that whereas under the old dispensation the Court always included several ex-governors able, if necessary, to dispute an issue on an equal footing with the Chair, Norman's long tenure of office turned him into something approaching an absolute monarch.

The second development was connected with the Exchange Equalization Account. Before its establishment, monetary management was a monopoly of the Bank; but the Account was the Treasury's engine, and its large assets and the secrecy of its operations caused it to become a dominant influence in the market. Obviously the two money powers had to co-ordinate their actions, and so Whitehall and Threadneedle Street formed an alliance if only in order not to spoil each other's game. The days were ending when it would be possible for a Chancellor of the Exchequer to say as did Gladstone: 'I was tenaciously opposed by the governor and deputy-governor of the Bank, who had seats in Parliament. . . .' The outbreak of war immediately strengthened the ties created by earlier co-operation, for the Bank of England was appointed the Government's agent for supervising the day-to-day working of the exchange control regulations. It was fortunate for the Bank that it had had the

opportunity provided by the Exchange Equalization Account to learn something of the intricacies of the foreign exchange market; but even with this apprenticeship it would have made a poor job of handling its new duties if there had not been made available to it the rich store of experience of the foreign exchange brokers now left without employment by the concentration in the Bank of all price-quoting.

The union of interests between the Government and the Bank gravely disturbed the balance of powers in the City, as delicate a balance, though unevidenced by any statute, as that enshrined in the American constitution. The wartime regulations, by giving the Government and its agents the right of inquisition into all transactions that might involve any foreign interest, enormously stimulated the tendency to aggrandizement at the centre and but for the pressing dangers of the time the clearing banks might not have been as submissive as they were. Here the soothing influence of Montagu Norman may have played a part; his long years at the helm gave to his wishes and views an authority lacking to the orders of a lesser man, and the City could not believe that one brought up in the tradition of free merchant banking would prove false to the lessons of a lifetime. So when, in 1944, the Bank celebrated its 250th anniversary it did so in an atmosphere of goodwill and the modest wartime festivities proved an occasion for heartfelt congratulations to the Old Lady. One thing only marred the happy day —the governor, worn out by the burdens of office, had felt it necessary to abdicate and to retire into private life.

A verdict on Norman's twenty-four years in the Chair must await the publication of much material at present unavailable to the historian, but nobody can read the

monetary history of the past quarter of a century without realizing that no permanent governor could fail to arouse frequent opposition, whatever his policy or lack of policy. While events are still of topical interest, the clash of differing opinions naturally attracts more attention than the quiet working of consenting parties, and there have been occasions when the critics of Norman enjoyed considerable limelight; but each time the dust of conflict subsided, the governor was found to have become more strongly entrenched than ever, with the army of his supporters increased by the adhesion of many former adversaries.

Lord Norman, as he became on his retirement, was succeeded by Lord Catto. The new governor had had no previous connexion with the Bank, apart from a short spell as a director in 1940, but his business record admirably fitted him for his new position. For some years he had served on the board of the great merchant banking house of Morgan Grenfell; before that he had filled a wide variety of posts—in shipbuilding, in an Eastern merchant house, and in the United States. There can have been few candidates better qualified at once to understand the needs of the City and the problems of producers.

Lord Catto proved to be the last governor to be chosen after the traditional manner. The general election of 1945 returned to power a party which had declared in its electoral manifesto that 'the Bank of England with its financial powers must be brought under public ownership, and the operation of the other banks harmonized with industrial needs'. The verdict given at the polls was interpreted as a mandate to nationalize the Bank and the new Government wasted no time, the Bank of England

Act being passed into law in February 1946. This important statute is commendably short and free from jargon. The governor, deputy-governor, and the twenty-four directors surrendered office and were replaced by a governor, a deputy-governor, and sixteen directors appointed by the Crown. Under the old system the unwieldy Court had been nominally chosen by the stock-holders possessing £500 or more stock. The choice had been made exclusively from merchant bankers; joint-stock bankers and members of the discount market were traditionally excluded. One or two leading industrialists and economists had of recent years been allowed within the charmed circle, but the general composition of the Court in 1945 still closely resembled that of a hundred years earlier. Under the new order, the directors were to be chosen from any walk of life, and according to the Chancellor of the Exchequer the Government would recommend to the Crown 'persons of suitable and varied ability and knowledge'. The governor and deputy-governor of the nationalized Bank are appointed for a term of five years and are eligible for re-appointment. The first governor chosen was Lord Catto, thus making it certain that there would be no sudden break and that the Bank would retain the services of a first-rate leader. In the ordinary way the new directors will hold office for four years, but a schedule to the Act provided that of the first set appointed in 1946 four should retire after one year, another four after two years, and another four after three years. No Member of Parliament or Minister of the Crown may hold any of these offices and not more than four of the directors may be employed to give their exclusive services to the Bank. The Court is responsible on broad lines to the Chancellor of the Exchequer, who

has the duty of answering for the Bank in the House of Commons, and is thus vested with the ultimate power and responsibility.

The variety of publicly-owned concerns in Britain is considerable and the principles behind their structure often obscure. Governors of the British Broadcasting Corporation are appointed by the Crown; the directors of the erstwhile London Passenger Transport Board were not: and in neither case has there been any legal responsibility to Parliament, from whom the powers originated. In the nationalized Bank of England's formal subservience to the State there is a logical demonstration in practice of socialist theory and, from now on, no Ministers of the Crown will be able at one and the same time to enjoy the benefit of the Bank's skilled advice and to maintain blandly in the House that they could accept no responsibility for the Bank's acts.

The right relation between the Treasury and the Bank, and between the Bank and the joint-stock banks, was discussed at considerable length during the nationalization debates. Prior to that time, the Bank, as banker both to the Government and to the clearing banks, formed an admirable medium for conveying the former's wishes to the market: and all was done by persuasion. This delicate play of forces was one which would be difficult to perpetuate or to express formally in an Act of Parliament, and many feared that a wording would be used so vague as to lay the banks open to an unreasonable measure of inquisition. After a good deal of argument a clause was devised whereby the Bank, if it thinks it necessary in the public interest, may request information from, and make recommendations to, bankers, and may, if so authorized by the Treasury, issue directions to

bankers to comply with a request: but the request must not be made 'with respect to the affairs of any particular customer of the banker', and before the Treasury authorizes a direction the banker concerned shall have a right of 'making representations with respect thereto'.

This provision does at least safeguard the fundamental legal privilege of a customer that his business with his banker shall not be disclosed by the latter except under exceptional circumstances long recognized and clearly laid down by the courts of law. Nevertheless, the City does not like this part of the Act, for it is easy to envisage it as becoming an unpleasant weapon in the hands of a hostile Government in spite of any saving words that may have been inserted. Up to now, no friction has arisen, for there has been small occasion for it; but let a major change in policy or general conditions come about, then the wisdom of our legislators will be severely tested. The declarations in Parliament made it plain that there is no intention to interfere with the daily work and routine of the joint-stock banks, but there is nothing in the Act to prevent the Government from using its wide powers to influence the distribution of credit by establishing priorities between different classes of borrowers and thus assuming control of an important part of the financial mechanism.

The compensation clauses of the Act deserve notice, if only for their neatness. The nominal value of the Bank's stock was £14,553,000, a figure at which it had stood since 1816. By the terms of the compulsory exchange the Government created an issue of stock carrying interest at 3 per cent. per annum and offered each of the 17,000 shareholders £400 of that stock for every £100 of the existing stock, thereby creating an issue of £58,212,000.

The reason for adopting this ratio of exchange was that the dividend on Bank stock had been an invariable 12 per cent. over the previous twenty-three years and would probably have continued at that figure had not the Government decided to nationalize. This approach to the calculation of a fair price would doubtless have had the approval of Lord Norman, for some years earlier he had said: 'In theory, the dividend paid on Bank stock can vary, just like that paid by any other company; but our proprietors have come to realize that service, and not a large dividend, is the first consideration.' The new stock is redeemable at par by the Treasury on or any time after 5 April 1966, and its holders can consider that they have received a fair exchange, as at no time prior to the introduction of the Bank of England Bill had the market price of the old stock stood above 398 per £100.

The transition from a privately owned to a nationalized Bank of England has been marked by few outward signs. The weekly return, published every Thursday, has suffered no substantial change in form. But for the vastly increased size of some of the items and the virtual disappearance of the gold holding, it would look familiar to the City men of our grandfathers' time, though the reforming spirits among them would notice with approval that the banking department's balance sheet is set out in somewhat greater detail than in Victorian days. Meagre as it is, however, the return is worth examining in order to learn something of the base on which the entire edifice of bank credit is reared. The table on page 90 is a specimen, that showing the figures as at 16 April 1947.

The liabilities side of the Issue Department is monopolized by the note-issue. The total is split in order to show how much is held by the Banking Department and how

BANK OF ENGLAND RETURN

16 April 1947

ISSUE DEPARTMENT

	£		£
Notes Issued:		Govt. Debt . . .	11,015,100
In Circn. . .	1,396,530,913	Other Govt.	
In Bankg.		Securities . . .	1,438,297,863
Department	53,716,920	Other Secs. . .	680,268
		Coin other than Gold . . .	6,769
		Amt. of Fid.	
		Issue . . .	1,450,000,000
		Gold Coin and Bullion (at 172s. 3d. per oz. fine)	247,833
	1,450,247,833		1,450,247,833

BANKING DEPARTMENT

Capital . . .	14,553,000	Govt. Secs. . .	348,175,660
Rest . . .	3,182,232	Other Secs. . .	
Public Deps. ¹	8,960,837	Discounts and Advances . . .	12,377,957
		Securities . . .	17,520,656
Other Deps.:			
Bankers . . .	305,694,893	Notes . . .	29,898,613
Other Accts.	100,096,197	Coin . . .	53,716,920
			695,966
	405,791,090		
	432,487,159		432,487,159

much is lying elsewhere—in the tills of banks and shops, in the pockets of the general public, in the secret places of the evader of income tax. That part of the note-issue covered by gold now amounts to only slightly more than a quarter of a million pounds and the fiduciary issue

¹ Including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts.

in the return we have chosen stood at £1,450 million. This huge figure was 'secured' by about £7,000 of silver and by considerable quantities of bits of paper bearing comfortable-sounding names. At the head of this balance-sheet army stands the £11 million of Government debt owed to the Bank from its earliest days. Next comes the monstrous regiment of Other Government Securities, much of which has the duty of replacing as best it can the golden legions of happier times.

The upward limit of the fiduciary issue is determined by Parliament—in other words, the Bank and the Treasury decide an increase is desirable, the Chancellor of the Exchequer tells Parliament, and Parliament always agrees. Reductions in the issue can be made on a Treasury minute requiring no parliamentary confirmation. When a reduction takes place it does so very unobtrusively, the first proclamation of it being an alteration in the figure given in the return of the Issue Department. Until the autumn of 1947 a decrease in the fiduciary issue was exceptional and by then the City, inured to progressive increases in paper money, had almost come to believe that the movement would be endlessly upward. Suddenly, however, it was reversed by a variety of forces, and every now and again a weekly return would record a falling back in this index of inflation. By May 1948 the figure had contracted to £1,300 million and the general economic climate promised a continuation of the downward trend—but we are still a fantastic distance from the £200 million of 1937.

It must not be thought, however, that the nation's stock of gold is limited to the miserable figure disclosed in the return. Somewhere or other the Treasury has a

large quantity of gold and 'hard' currencies such as dollars which it employs as a secret *fonds de manœuvre*.¹ Every now and again the Chancellor tells Parliament what the size of this fund was some six months back and the monetary experts employed by the financial papers then engage in abstruse calculations which ultimately produce a guesswork figure for the present.

The valuation placed on the small revealed gold holding merits comment. The price of 172s. 3d. per fine ounce is a 'real' price in the sense that, with the London-New York rate at 4.02½, it is in line with the United States official gold price of \$35 an ounce. We have not always been so honest in our book-keeping. When we went off the gold standard in 1931 the gold holding was kept in the return at the old value of 85s. that it had enjoyed since the resurrection of the standard in 1925. Thus a part of the holding constituted a kind of secret reserve, as with the under-valuation of any other asset. During the following years, the scramble for gold, of which mention has already been made, drove up the paper value of the metal to nearly 150s. and it was ultimately decided to revalue the Bank's stock at the current rate, week by week. In March 1939, the result was seen in a sudden and large increase in the return's Gold Coin and Bullion figure, the paper profit on the transaction being pocketed by the Treasury.

Since the outbreak of the Second World War, the price of gold has been pegged so that changes in its formal value rarely occur, but it is always in close relation to the American price. Some other countries have still retained fictitious values for their gold holdings and

¹ In July 1948 the Chancellor of the Exchequer gave the figure as being £473 million.

among them there are States as enlightened as Denmark. The object of this little deceit is obscure, as its only result is to muddle anybody wishing to ascertain the true position.

The ordinary working part, the Banking Department, tells the inquirer rather more of our financial system. Starting with the liabilities, we find the Capital shown at its pre-nationalization figure. This capital is now owned by the general taxpayer as represented by the State. Public Deposits is mainly the money standing to the credit of Government Departments, many of whom possess large balances from time to time, but the balances of savings banks are also included. Other Deposits is divided into 'Bankers' and 'Other accounts'. Bankers deposits relate only to British banks whose main business is concentrated in this country. Balances of other banks operating mainly in the Dominions and foreign countries are included in 'Other accounts'. 'Other accounts' include also balances held by foreign central banks, merchant banks, financial houses, and the Crown Agents for the Colonies. For several years now the Bank has accepted no new customers other than bankers but it has retained those it had; as a glance at the return will show, their deposits are large. The remaining liabilities are represented by the accumulated visible reserve, called with admirable simplicity the Rest. It has been customary to keep these undivided profits at a figure which never falls below £3 million. Taking two other dates at random, when Peel's Act came into force in 1844 the Rest stood at just over £3½ million and in November 1928 it was £3½ million. In the days when a pound sterling was equivalent to just over 113 grains of pure gold, the weekly sight of this Rest was a constant

reminder to the British people of the prosperity and solidity of the Bank; to us who may be said to have passed through to the other side of the Norman Era, it remains an interesting relic of the Golden Age.

The assets of the Banking Department, as disclosed by the return, are not very enlightening. Behind them lie the hidden reserves. 'Inner reserves' are deemed essential to the strength and prestige of any great financial institution and this view has the support both of the recent Cohen committee on company law reform and of the Companies Act based on its recommendations. As far as the Bank is concerned, Lord Catto informed the select committee on the Bank of England Bill that the undisclosed reserves were not excessive considering the magnitude of its operations and that, were the figures published, a flood of useless argument would be let loose between those who thought the sum excessive and those who thought it too small. One example will illustrate this: nowhere in the assets is there to be seen any reference to the land and buildings owned by the Bank. What are they worth? What *would* they be worth on the open market were the Bank to fail and have to sell its assets? In the last analysis the value of these imposing masses of masonry proves almost as intangible as the invisible goodwill that also forms one of the most precious assets of a successful business.

CHAPTER 7

THE CLEARING BANKS

THE MOST important of the Bank of England's customers are the eleven clearing banks. If we exclude the National Bank, because its main sphere of activity is in Ireland, we are left with a group whose members possess very much in common. The paid up capital of these ten concerns amounts to about £76 million but the banks themselves vary considerably in size. If we take the figures at the end of 1945, we find that the bank with the largest amount of deposits was the Midland, which had in its keeping the huge sum of £1,060 million. It had assumed the leadership some years earlier, although its paid up capital is a little less than that of either Barclays or Lloyds, the other two members of what we may call the Big Three.

In December 1945, the total deposits with the clearing banks amounted to £4,812 million, so that every pound of deposits rested on a slender column of 3s. 2d. of paid up capital. Fortunately for the depositors' peace of mind (supposing depositors to think of these things) there was other support—the banks' visible reserves. These amounted to over £66 million and, in addition, there were yet further reserves, hidden from the uninstructed gaze of the crowd in the market place.

A closer examination of the capital figure in the banks' balance sheets shows that whereas paid up capital stands at £76 million, what is rather misleadingly called subscribed capital is shown at about £246 million. The

difference between these two sums is represented by money that shareholders undertake to provide in certain contingencies; and the main misfortune envisaged is the failure of the bank. Practice varies here as in many other matters. Barclays Bank, for instance, has a paid up capital equal to its subscribed capital and cannot call upon its shareholders to provide another farthing; while Coutts & Co. is a company with unlimited liability and, though its paid up and subscribed capital are one and the same, the shareholders have a financial responsibility for any deficit, however big. Most of the clearing banks divide their uncalled capital into two sections—'callable' and 'reserved'. The former is available for the development of the business if the directors so decide, while the latter may only be demanded should the bank be unable to pay its creditors, among whom the depositors are the most important. The massive block of reserved liability (it stood at £138 million in 1945) is supposed to give a feeling of confidence to account holders, and the existence of the shareholders' conditional promise doubtless did comfort customers in Victorian days, when banks were much smaller and far more vulnerable. Now, when no one of the clearing banks can fail without shaking the foundations of all, the usefulness of the reserved liability undertaking is not so obvious, and account holders, if they think about it at all, may be excused for doubting whether the shareholders could indeed live up to their promises. The only relevant case in recent years is instructive. The Anglo-South American Bank, whose shareholders had an uncalled liability of £4 million, failed in 1936. No attempt was made to collect what was due from them and the loss was shouldered by the banking community in general. In the light of this experience

there seems to be something to be said for the attitude of Barclays Bank in eschewing the advertisement of a reserve of moneyed shareholders.

The total of the clearing banks' deposit and current accounts at the date we have chosen stood at £4,784 million. The source of a great deal of this money will be found under 'Discounts and Advances', which stood at £2,702 million and swelled deposits in two different ways. When a bank discounts a bill it credits the customer's account with the money it pays him for the bill; when it makes him an advance by way of a loan it debits him in a loan account and credits a corresponding sum to his current account; when it grants an overdraft, the customer is allowed to make payments out of his current account even though he possesses no credit balance. The cheques drawn by the customer in favour of other people go to the credit of *their* accounts and thus it comes about that every loan creates a deposit except in the few cases where the borrowed money is paid to somebody in notes that for some reason never find their way back into a bank account.

Two questions are often asked about the money lent by banks—what, if any, limit is there to its amount, and who are the borrowers? The lending power of banks has been much misunderstood but there is not really a great deal of mystery about it. A bank does not lend its capital or reserves; the former is used to buy offices and equipment and the latter are invested in suitable securities. What is lent is lent out of the deposits; how much is lent depends on how much sound borrowers choose to ask for and (in a country with a managed currency) the quantity of the means of payment allowed to the people by the State. Left to themselves, the banks would lend

all of the deposits that it would be safe to lend. If the chance of customers' withdrawals is an average of £10 on any one day out of every £100 of deposits, then it looks as if it might be safe to lend the remaining £90 less a small margin as an insurance against bad debts. But as every loan creates a deposit, the advances made by one bank swell the deposits (and therefore the lending capacity) of its neighbour and the way is opened to an endless spiral of borrowing and deposit-creation. Now nothing like this happens in practice. To start with, a man may be persuaded to open a banking account but his bank, even were it so foolish as to wish to do so, could not persuade him to go on borrowing. Sensible people contract loans only when they think they can use the money to advantage, and there is always a limit to the ways in which this can be done. Banks to-day charge at least $3\frac{1}{2}$ per cent. per annum to the ordinary borrower and it is not at present easy to use money so that it yields a net return much higher than this figure. There come, however, times of feverish business activity during which the chances of large and quick profits dazzle the eyes of commercial men and investors on the stock exchange. When one of these phases recurs, the vast lending power of the banks is capable of making dynamic that hope of getting 'something for nothing' which lies tucked away in the hearts of nearly everybody, and were that power released there would be a brief, wild debauch of gambling followed by a morrow of repentance and bad debts. Fortunately the urge to borrow in order to win sudden riches is restrained by the banks themselves, there being few things more odious in a bank manager's eyes than the sight of an overdraft that will never be repaid. The advance that has gone 'sour' represents not only a nasty

loss to be explained away somehow or other to his superiors but also a constant affront to his professional pride, so in times of boom the optimistic proposals of borrowers are subjected to a cool if friendly examination ending, often enough, in nothing more than some ungratefully received good advice. As a matter of historic interest, it is perhaps worth mentioning here that in the good old days prior to 1914 banks had a conventional maximum limit of 50 per cent. of their deposits that they were willing to lend in 'advances'.

The art of lending is a difficult one. There are so many factors to be taken into account that the grant or the refusal of an advance is frequently a choice calling for a high degree of judgement. Any banker can recognize certain advances as safe and others as dangerous, but in between these extremes lie the majority upon which he will be asked to decide. He himself will be but a man, and therefore subject to the great tides of opinion that rise and fall about him, so that when markets are improving after a slump he will perhaps be moved by a sanguine disposition to over-estimate the extent of probable recovery; or when a temporary recession takes place, he may be led by an atrabilious turn of mind to call in advances with unnecessary harshness and thereby make things worse than they need be. But even the best-balanced of bankers is bound to make mistakes, and for at least four reasons: the statistical material which he calls to his aid in interpreting trends is inadequate, though more ample than it used to be; the forces influencing markets are numerous and disturbing; history rarely repeats itself very closely; lastly, the most skilful lender can sometimes be wrong in his estimate of the borrower's ability or honesty.

So it comes about that the proportion of deposits lent always falls short of possibilities and in an earlier chapter attention was drawn to how much less banks were lending to-day than they would wish. The lack of advantageous inquiries from borrowers is due to various causes whose analysis falls outside the scope of this book, but the clearing banks' figures already mentioned show that advances at the end of 1945 absorbed a mere 17 per cent. of deposits. The largest earning item was the somewhat unremunerative Discounts, which accounted for 40 per cent., while loans to the money market for very short periods (often only overnight) took 5 per cent. Cash in Hand or at Bank of England, none of which earns a farthing, equalled 9 per cent., and the remainder of the deposits found its way into British Government or other securities, including Treasury Deposit Receipts.

An examination of the published accounts of one of the big banks will not materially increase our knowledge of where the money goes. The so-called profit and loss account is in fact little more than a statement showing how it is intended to divide the profits after all the interesting expense items have been dealt with behind the curtain. Thus there are no figures to show what the salary bill is: this is a pity, as salaries form a very great part of a bank's expenditure and fluctuations in their aggregate are of interest to all whose business it is to calculate the purchasing power of the middle classes. No disclosure is made of the amount lost in bad debts: this reticence cuts both ways in that it prevents the intelligent minority from realizing that lending is a risky business which is being conducted with great skill, while it also deprives the rather silly majority from making stupid comparisons between different years and different banks.

This paucity of information in the accounts is partly due to tradition and sturdy competition among our banks, but the doctrine of each for himself has been in many ways modified of recent years. Various arrangements for mutual aid have become important, and will call for description later, but one of them can be properly touched on here, as it gives a partial answer to the question—Who are the borrowers? Every quarter the British Bankers Association publishes a table showing the advances granted by its sixty members divided according to purpose, and a very interesting document it is. The borrowers are classified under twenty-five heads and the amount of credit accorded to the different groups throws some light on the affairs of the nation. In the February 1947 table the total advances came to £1,027 million, a welcome rise of £179 million from the figure of a year earlier. One group, and one group alone, borrowed more than a tenth of this—No. 25, 'Personal and Professional', which accounted for 28.7 per cent. Perhaps the compilers of the table found it impossible to subdivide this large class, but even in its undifferentiated mass it shows that a great part of banks' advances goes to help people in activities that cannot strictly be described as trading.

There are only a few other groups whose borrowings are in excess of one twentieth of the whole and the list is capable of various interpretations. Here, expressed in percentages, are the shares of some prominent sections: Retail Trade 8.6; Agriculture and Fisheries 7.8; Local Government Authorities 7.7; Engineering 7.1; Food, Drink, and Tobacco 6.3; Builders and Contractors 5.1.

Several of our great industries do not appear among the first ten and some seem to get along quite happily

with very little help from the banks. The iron and steel trades, for instance, account for 1·4 per cent. only and the three textile groups together notch a bare 2·4 per cent. On the other hand, the growing importance of commercialized amusement is shown by the fact that the entertainment industries take as much credit as textiles, and the inadequacy of private generosity by the fact that the combined borrowings of churches, charities, and hospitals exceed those of shipping and shipbuilding.

Analysis of business credit-takers is carried much further in America than with us. For example, the Federal Reserve Board, the main banking authority in the United States, divides 'retail trade' into five sub-sections and shows what part each contributes to the whole and what is the average sum borrowed. Detailed separation of this kind provides material for a more reliable index of borrowing tendencies (and so of business activities) than can be obtained from the British table and it is to be hoped that we shall before long pay this example of transatlantic mass observation the compliment of imitation. The unsatisfactory nature of rudimentary classification may be seen in the heading 'Agriculture and fishing'. There may be some sense in placing both these occupations under the care of one Government department but there is none in treating them as homogeneous when it comes to their financial requirements. In the absence of a separation it is impossible to draw any conclusion about either from a study of the quarterly figures, but we can safely say that both must by now have repaid the frozen advances that hung round their necks like millstones in pre-war days and that the sum owing represents fresh, constructive borrowing.

Though the lending of money is a very important

function of the trade of banking, the banks' heaviest duties are the organizing of cash payments and receipts across the counter and the clearing of cheques. There are other banking services calling for notice, however, and most of them are rendered gratuitously. The custody of valuables such as stocks and shares and deed boxes relieves the owner of these things from the fear of loss or theft. Arrangements can always be made for the bank to collect the dividends or interest yielded by securities, and the bank will watch the financial papers for notices of repayment schemes, offers to shareholders, and all the various other announcements of that type. To customers unused to the management of this kind of wealth, or whose business takes them much out of the country, the securities service of the banks is a great boon.

It is often a convenience to a customer to have money made immediately available at places other than the branch at which the account is maintained. A person may be staying in a town far removed from his bank but he can always arrange to cash his cheques and pay in credits at a convenient local office. Should he decide to travel, his bank will supply him with travellers' cheques payable all over the world or with a letter of credit enabling him to draw money at a wide range of foreign banks, and he will be helped with all the troublesome formalities of passports and exchange control forms.

For traders, the banks' information services can be of the utmost value, and the basis of trust on which our internal mercantile transactions rest could not exist but for the voluminous credit files which are constantly being brought up to date. The exporter, also, who receives an order from an overseas buyer can obtain knowledge of the latter's standing and business morality, and he can

learn what, if any, payments restrictions exist in the importer's country. Manufacturers who are called upon to supply large orders taking a long period to execute have sometimes good reason to be nervous of the political and economic trends in the buyer's country, and, once again, the banks are ready with an up-to-date advisory service. To-day, more than ever before, Britain depends on her exports to secure the essentials of life, with the result that hundreds of firms with little or no previous export experience are engaging in foreign trade. Towards these newcomers a banker feels a special responsibility and, if he knows his job, he will often be able to help; the small craftsman will be directed to the type of import house which is seeking his products, the exporter who has lost his former markets because of the war will be guided to fresh woods and pastures new. And for all, whether they be private persons about to take a pleasure trip, or business men with foreign payments to make or receive, the banks provide an elaborate currency exchanging service which arranges for present or future wants by the use of a technique perfected through generations of practice in the world's most sensitive monetary centre.

There is one branch of our banks' services that calls for more than a passing mention—the Executor and Trustee service. Until comparatively recent times an executor or a trustee had to be an individual and the evils arising out of this were the subject of ineffective comment for many years. As long ago as 1886 a Bill was unsuccessfully brought before Parliament with the object of establishing official trustees and executors and to enable incorporated companies to act in these capacities. A Select Committee of 1895 reported 'that large sums of

money are annually misappropriated by private trustees and that much loss and consequent suffering is caused by the malversation, and that those who suffer are chiefly the poorer and more helpless', but it required a decade of agitation before the Public Trustee Act of 1906 partially met the need.

This legislation, which did not come into force until 1908, appointed a State official to act as a trustee or executor if asked by testators to do so, and it also permitted approved banking and insurance companies to carry out such duties. Six banks at once applied for licences and others followed suit, but the new service made ground very slowly. The administration of trusts and estates is fundamentally different from ordinary banking work; it requires specialized training and the old guard of bank managers fought shy of it. The Act also retained various legal impediments which were not swept away until the passing of the 'Birkenhead' Acts of 1925 and, above all, big changes of this kind took a long time to win acceptance from the general public in the days when banks scorned all but the most formal kind of advertising.

The relaxation of the statutory restrictions enabled the various trustee departments to organize an efficient service and to open up special branches in the large towns, so that when the cloud of war swept up in 1938 they were able to cope with the rapidly increasing demands of a people made suddenly aware of the nearness of Death in his most undiscriminating mood. Men and women, impressed by the shortness and uncertainty of life, sought hurriedly for an executor or trustee possessing immortality, honesty, and some acquaintance with their affairs, and all these qualities were placed at their

immediate disposal through any one of thousands of bank offices.

Another factor increasing the calls upon the executor and trustee service has been the considerable rise in the number of estates liable by their size to death duties. This rise is partly due to the steady inflation of our paper currency but it has also been in some measure brought about by the spread of habits of thrift. During the past twenty years declared estates have nearly doubled in number, from 106,000 to 196,000, and a growing proportion of them has been falling to the banks' trustee departments to administer.

All this business has been obtained in competition with the Public Trustee and in face of the still strongly-rooted habit of appointing solicitors or personal friends. There are no precise statistics available, but a recent writer on the subject made a comparison of the executor and administrator appointments mentioned in the *London Gazette* and found that while in 1929 banks accounted for only 8 per cent. of these, as against 8.1 per cent. Public Trustee and 82 per cent. individuals, by 1946 the percentage shares of the same three classes had changed to 41, 3, and 55. Should this trend continue, a time will come when the appointment of a bank will be considered the normal method of arranging for the administration of estates, and the absconding trustee will have disappeared except from the pages of old-fashioned novels.

The massed figures of advances in the table prepared by the British Bankers Association give a misleading idea of concerted policy among the Association's members. As a matter of fact, the field of co-operative effort is still relatively small although the area covered is important. From very early days there has existed at least

some measure of common action between the various banks. Its first extensive manifestation was the organizing of a method of clearing cheques through an institution owned collectively by several of the London bankers. This venture deserves attention because of its antiquity, because it was the means of bringing numerous banks together daily, and because the contacts so established led to further experiments in mutual aid when the time proved ripe.

The bankers' clearing house started accidentally, as so many useful things do. When a bank takes in from its customers cheques for the credit of their accounts, the majority of the cheques will be drawn on other banks and have to be presented to those banks for payment. For nearly a hundred years presentations were made by sending out clerks who had to call at bank after bank and receive payment in notes and coin. It was a laborious method of settling debts and one laying the messengers open to a grave risk of robbery in a London all but innocent of police. The way out was found by the clerks of the City, for they took to meeting together at a convenient hostelry in order to exchange their claims and arrange the settlement of differences. The exact procedure followed by these enterprising young men is a secret that has died with them but the results of their illicit gatherings were so satisfactory that the banks decided to learn from their employees, and what had started as an irregular departure from strict orders was transmuted into an official gathering. Somewhere about 1770 a room was engaged in a court off Lombard Street and, though the inter-bank differences continued for many years to be settled in legal tender, the systemization of the 'clearing' effected a considerable saving in the

quantity of ready money which every banker has to keep eating its head off in his tills. Later, when it became customary for all the clearing bankers to maintain accounts at the Bank of England, it was possible to take the final step in rationalization by dispensing entirely with cash settlements, for any bank which was a debtor on a particular day was then able to discharge its liability by a settlement through the common clearing account at the central institution.

In 1938 the clearing house, having outgrown more than one home, moved from its quarters in Post Office Court, Lombard Street, in order that these could be extended and rebuilt. Unfortunately the war broke out while the site was little more than a big hole surrounded by steel girders, and subsequent hindrances have made it inevitable that the clearing shall be conducted in makeshift premises for some time yet.

The clearing was for many years confined to cheques payable within the City proper. It is easy to understand why country cheques were not cleared through London until about 1860, for an efficient country clearing presupposes the existence of a satisfactory railway system, but it is curious that the clearing was extended to the suburbs only forty years ago. To-day, every owner of a cheque book will find the cheques marked with either a T, an M, or a C to indicate whether they are to pass through a Town, Metropolitan, or Country clearing on their journey from one bank to another.

The London clearing house is not the sole settler of the claims created by country cheques. In the large provincial cities the volume of transactions justifies the existence of subsidiary clearings, and for over seventy years Manchester has set off its local claims on the spot.

Other towns have followed suit, so that there are to-day eleven provincial clearings. As most of the turnover in these clearings represents commercial business as distinct from 'financial' payments such as arise from dealings in stocks and shares, its variations provide a useful index of industrial fluctuations and the activity of a particular clearing house may be taken as a rough guide over a period to changes in the progress of some broad trading group, so that the Bradford clearing will tell a story about wool and Manchester one of cotton textiles. Scotland has clearing houses of her own, but as no figures of their turnover are issued their activity cannot be used to throw light on the ups and downs of Scottish industry.

The London clearing house is manned by teams supplied by the constituent banks. These teams, working at a high speed, sort out to the banks on whom they are drawn the cheques remitted by the collecting banks the previous evening from all over the country. Messengers from the paying banks pick up the bundles belonging to them and take them to their respective offices, where they are examined and, if paid, debited to the accounts of their drawers. Sometimes a cheque is returned unpaid; these black sheep are marked with the reason for their refusal and travel back to the collecting banker by post, except that town clearing cheques are rushed back to the clearing house by messenger. While all the sorting is going on, a rapid game of Ins and Outs is being played with the help of calculating machines, and by about 5 p.m. the various balances are struck and agreed so that the necessary transfers can be made by the Bank of England the following day. In addition to the cheques delivered for sorting in the morning the clerks have to deal with those paid in to City offices on other City

offices during the day up to closing time (at present 3 o'clock) and hurried round by walk clerks; and last of all come the 'unpays', which must be got in early the next day, for otherwise the presenters of them will have a right to assume that they have been honoured by the banks on whom they are drawn.

The knowledge of each other acquired by the banks in their common task of cheque clearing, while never lessening their desire to compete, did lead them to see that there might be advantages in extending the area of collective action. The First World War hastened the gradual tendency to consultation and in 1920 the British Bankers Association was born. Its rules are few and simple, the primary object being 'the provision of facilities for the discussion of matters of interest to Bankers'. Membership is open to three classes of British banks: those whose main business and head office is in the United Kingdom, those whose main business is outside the United Kingdom but who have an office in the United Kingdom and are members of the British Overseas Bankers Association, and any other which is approved by the Committee provided it has an office in Great Britain or Ireland. The members of the General Committee are drawn from the directors or chief managers of the member banks, the seats being allotted between the different groups so as to secure a body that is thoroughly representative. The B.B.A.'s membership is in the neighbourhood of sixty. In addition to the eleven clearing banks, the main sections consist of the twenty-five or so overseas banks, the eight Scottish banks, and the seven Irish banks. Under the General Committee there are sub-committees dealing with specific tasks or branches of banking. The Committee of London Clearing Bankers,

for instance, holds regular meetings whose purpose is explained by its title and its importance is recognized by the fact that once a quarter it meets within the walls of the Bank of England under the presidency of the governor. There is a committee that deals with general staff problems, the members of which had a busy time for a while during the late war when the Kennet Commission called for figures of manpower in banks. There is a premises committee and that, too, was not idle when London became the target of the German air force.

The General Committee considers the reports prepared by the sub-committees, authorizes the sending out of informative circulars to banks and finance houses, and is responsible for making any necessary approaches to the Government. The notifications to the market either convey Treasury orders or else the recommendations of the B.B.A., and the latter are treated with almost as much respect as the former, even by those (such as the London offices of American banks) who are not members of the Association.

CHAPTER 8

ESSAYS IN CO-OPERATION

CONTINENTAL WRITERS on the organization of credit have commented on the absence in our island of any bank specifically devoted to the interests of agriculture, even now our largest and most widely spread industry. To those critics who point to the lack of a land bank as a weakness, it might be answered that such an institution, wherever found, is usually little more than a respectable façade to a state subsidy which it were better and cheaper to give openly, and it is doubtful whether even their most enthusiastic exponents could show that agricultural banks are likely to prove profitable under British conditions.

It does not follow, however, that our agriculture has not got credit problems markedly different from those in the remaining branches of economic activity, and there is among us a strong feeling that when land is being considered there are other criteria besides the nice calculation of book profit and loss. The bitter depression among farmers after the First World War led to an agitation that this feeling should be translated into action, that there should be a practical recognition of the special nature of agricultural credit. The answer to the cry for help was the Agricultural Credits Act of 1928, which made special arrangements to meet both the farmer's short- and long-term needs. The former were dealt with within the existing structure of English banking by the legalization of a mortgage of farm assets, such as build-

ings and crops, in a particular form called an agricultural charge. A very few years' working was enough to show that the arrangement was generally unpopular, and it is probably true to say that to-day most short-term lending to farmers proceeds on the traditional lines—generous unsecured advances to the able farmers and as little as the banker can to the others.

The Act's long-term arrangements are carried out through an autonomous body called the Agricultural Mortgage Corporation, established in England and Wales. Its ordinary capital is subscribed in different proportions by the big banks and its loan fund is drawn from issues of debentures. Unfortunately, the period immediately following the setting up of the Corporation was one of fairly stiff money rates, so that the debentures were issued at rates as high as 5 per cent. and never lower than 4½. Even when our farms are fairly prosperous, lending rates based on these capital costs must be unattractive and it is significant of the increased appreciation of our need of home-grown food that the Corporation is now making advances at 3½ per cent., the difference being subsidized by the Treasury. At 31 March 1946 outstanding advances totalled a little over £7 million, with an average repayment period of forty-six years. This sum seems small in relation to the industry's requirements and when one takes into account the fact that the farmer has the certainty that his loan will not be called in by reason of the lender's death or because the money is wanted for other purposes; but it must be remembered that much of the capital expenditure on agriculture is devoted to projects covering a far wider stretch of ground than that belonging to a single farm, and these have to be financed by

Government grants to authorities such as catchment boards.

A more impressive example of inter-bank co-operation is provided by the Industrial and Commercial Finance Corporation, formed in 1945 in order to help enterprises to whom stock exchange facilities are not readily available. The nominal capital of the Corporation is £15 million; of this the Bank of England subscribed a token £500,000, the balance being put up by the main English and Scottish banks. The I.C.F.C. deals with borrowings ranging from a minimum of £5,000 to a maximum of £200,000, while larger proposals come within the scope of a second body, the Finance Corporation for Industry, whose capital of £25 million is derived from the subscriptions of a consortium of insurance companies, investment trusts, and the Bank of England.

When the Macmillan Committee on Finance and Industry sat in 1930 a good deal of evidence was given purporting to show that the market was inadequately organized to supply the medium- and long-term requirements of the smaller concerns. The deserving big company, it was said, could always have access to additional capital through the machinery of the stock exchange, but a factory employing perhaps fifty people and requiring a modest £10,000 for a promising scheme of development had no means of raising the money from the general investing public and was usually unable to find local lenders. The banks, beyond expressing doubts as to whether the demand for additional facilities really existed, had little or nothing to contribute to the discussion, though their negative attitude would have carried more conviction had they made a practice (as did the German banks) of using their funds for direct

participation in industrial ventures. Very wisely, they had always restrained from the dangerous habit of immobilizing liquid assets, but that in no way weakened the basic argument of businesses which conceived themselves to be capital-hungry in the midst of plenty.

Between 1939 and 1945 events conspired to strengthen the hands of those who had maintained that there was within the nation a worthy class of producers whose progress was being impeded by an absence of appropriate facilities for getting at capital. Those years saw a progressive depletion and disorganization of the ranks of private investors in face of the reiterated and crushing demands for more and more income tax, and what investment there was tended to confine itself to shares dealt in on the stock exchange and thus subject to the test of open market quotation. Another cause which led the Government to reconsider the question was that the great rise in prices had correspondingly increased the monetary cost of reconstruction and rehabilitation just at a time when expenditure on these objects looked like becoming pressingly necessary in a wide number of small and medium-sized industrial units. *The Times*' comment was that the Macmillan gap 'did not exist when it was discovered but has come into existence as a result of the 1939-1945 war'.

The larger of the two autonomous bodies created to deal with the situation, the Finance Corporation for Industry, started under the chairmanship of Lord Bruce, a former prime minister of Australia and a distinguished elder statesman in Imperial councils. Besides its subscribed capital, it has powers to borrow a further £100 million to finance its works, so that it is capable of extending considerable assistance if it sees fit, but the first

statement, giving the position as at March 1947, demonstrates that more than a matter of months is needed to set this type of credit pump fully to work. By that date, existing commitments had come to only £7 million, a small sum where the minimum loan was £200,000; yet it is the big programmes that take longest to work out and to study, so the F.C.I. has been wise to hasten slowly. Subsequently the pace quickened, one of the new projects being a £900,000 participation in a venture directed to the development of a chemical-from-oil process which had its birth in the fertile brain of the great Jewish leader Dr. Chaim Weizmann; and before long the founders of the Corporation may have proved that there is in fact a fairly constant need of large-scale credit grants which cannot be obtained through normal channels.

If the F.C.I. is a good thing, the utility of the smaller body, the Industrial and Commercial Finance Corporation, is even less disputable. Even when some fairly small limited company can raise capital by a modest issue of shares the process is relatively costly, and for a partnership this approach to investors is closed. The big concern is so much with us through its advertisements and its other public displays that we are inclined to forget that a considerable part of the things we see in shops is a product of small factories. The 1935 Census of Production shows that firms employing from 11 to 99 workers were at that time responsible for a fifth of the country's industrial output, and it is for the benefit of these undertakings that the I.C.F.C. was designed.

The Corporation extends credit by two methods. It grants advances against good security at rates varying from 4 to 5 per cent., repayment being by agreed instalments, and it will also participate by taking up shares.

In cases of long-term financing there is always a participation in risk and profit, with a rule that a proportion of the profits shall be ploughed back into the business. During its short life the I.C.F.C. has been criticized for its lack of enterprise and also for venturing too boldly past the border line beyond which lies the territory of banks, insurance companies, and issuing houses. The outsider is unable to judge of these matters, but it is interesting that during the Corporation's first year only 133 applications for facilities were granted out of a total of 703. By February 1947 contracts approved were still well under £10 million, the average proposal amounting to £35,000.

The small use hitherto made of these two well-provided lending institutions serves as a reminder that money can of itself produce nothing; it can only fulfil a useful purpose if it joins hands with manpower and materials. The chronic labour shortage experienced since the war, combined with the scarcity of basic construction materials such as timber, must inevitably hold back all sorts of useful plans, and not until these difficulties are eased can we expect this new double-headed giant to display its powers to their full extent.

One other post-war enterprise to which the banks have lent their support must be mentioned here—the British Export Trades Research Organization, usually known as 'Betro'. This is essentially the affair of exporters, but several banks have joined as founder members in order to give it their blessing in a practical form. As its title indicates, Betro is concerned with research, the exploration and measurement of markets for British goods, a task beyond the powers of all but the biggest individual business houses.

It is too early to say whether Betro will become a permanent feature in our foreign trade landscape. Its aims are unexceptionable and its efficiency has already been proved, but it has to contend with one great difficulty at home. When there is a sellers' market, when everybody is willing to buy anything, exporters are inclined to grudge paying a subscription to an organization designed to increase their range of possible customers—and when international trade slackens, we may be sure that many firms will promptly feel that they are unable to afford to contribute to investigations which cannot guarantee to bring them profitable orders by return of post.

With this brief glimpse of Betro we leave the stretch of our commercial life where bank combines with bank to further enterprises which at best can only make an indirect contribution to the banks' profits, but their importance justifies more than a passing glance at the co-operative associations formed and maintained by the staffs of the banks. Outstanding among these voluntary bodies is the Institute of Bankers in England, founded in 1879 and possessing counterparts in Scotland and Ireland. Its activities may be divided under four heads. First, it acts as a professional examining body and awards its certificate to successful candidates. The examination is not an easy one to a man who must do all his book work in his spare time, for it embraces several subjects, none of which is alternative or optional. Evidence of this is provided by the results, which frequently show that less than half the candidates have reached a pass mark.

A less stern side of the Institute may be seen in its library. Here members can obtain books on such a wide variety of subjects that the shelves can claim to go some

way to satisfy Carlyle's definition of a true university and, in addition, there is a very fine collection of old notes which is constantly being added to by helpful friends. The books find their way to hundreds of readers in the provinces, but the most striking feature of the Institute's activities outside London has been the organization of numerous local centres grouped round our chief cities. These centres lead an active professional and cultural life during the winter months and the scope of their lecture programmes would do credit to any of the well-known discussion societies of past times. In the Metropolis itself, the Institute sponsors important courses of lectures on banking and finance, sometimes acting in conjunction with the University of London.

All these activities are gathered up, so to speak, in the Institute's *Journal*, where are faithfully reported all the legal decisions of interest to bankers and where are recorded the outstanding events of the banking world. To the outsider, the *Journal* cannot but have a forbiddingly technical appearance, but to the bank man interested in his trade it is a mine of information and a valuable guide.

At this point a digression on the financial press is justified. London now possesses only one daily paper entirely devoted to economic affairs, the *Financial Times*, but there are several weekly and monthly periodicals of this kind. Two of the monthlies are mainly occupied with banking, and both enjoy a high standing. The *Bankers' Magazine*, now more than a century old, has established, as befits its years, a reputation for conservatism, but it is quite capable of criticizing sharply the powers that be if it sees occasion to do so. For some years its peculiar contribution has been its educational

section, where every kind of banking problem is discussed, but recently the editor has also opened his columns very generously to the debating of all matters relating to the staffing of banks and to the status of bank employees in a time of economic change. The *Banker*, founded after the 1914-18 war, while dealing with every aspect of banking, is considered to be particularly authoritative in its foreign articles and it enjoys a high reputation abroad. These two magazines draw much of their virtue from their independence. Each is owned by a wealthy business with numerous other interests, so that questions of policy can be treated with a freedom hardly possible in the pages of the *Journal* of the Institute, and the result is that their views are read with respect even by bankers whose policies are not always praised.

Since the war, there have been some readers of the *Bankers' Magazine* who have felt that that fine old veteran was devoting too much space to the pros and cons of trade unionism among bank clerks. Such a feeling ignores the big changes of the past thirty years and, in particular, the rise of important organizations claiming to speak for the employees. These associations deserve to be mentioned here, for they are the fruit of the staffs' voluntary co-operation quite as much as is the Institute and they must have an important place in any study of self-help among clerical workers.

The Bank Officers Guild (now the National Union of Bank Employees) was founded during the First World War to watch over the economic interests of bank men and women. To-day, after a generation of effort, its membership comprises no more than a third of what is possible and there are few signs of further progress in the near future. The union covers England, Wales, and

Scotland and its failure to attract more support is of some interest in view of the overwhelming success of a similar organization in Ireland. One reason for the lack of response is to be found in the existence of various staff associations, organized bank by bank and acting on common issues through a central council. Membership of these internal unions involves only a tiny subscription, but it is doubtful whether cheapness is the main cause of their continuing popularity. It would be truer to say that they have survived because they express the feeling of separateness which lives on vigorously side by side with the spirit of co-operation.

What the stalwarts of the National Union of Bank Employees stigmatize as the narrow outlook of the members of the staff associations derives largely from the recruiting methods of the clearing banks. Once a clerk joins one of these banks he can never look for employment with any of the others, and if he wants to try his fortune in a non-clearing bank his choice is in practice very limited. So the new entrant soon learns to regard himself as a Midland man or a Barclays man, and as he grows older he finds (not altogether to his displeasure) that his mobility becomes further restricted by the gilded chain of a non-contributory pension right to which fresh links are added as the years go by. All these factors work together to create a feeling of oneness with the employing institution and an acute consciousness of the differences dividing the man in the permanent pensionable job from the man who has moved round from merchant bank to foreign exchange broking and back again, selling his skill for what it will fetch on the open market. Whether the immobility of labour in our big banks is in the best interests of the overall efficiency of

banking is another matter, a discussion of which may best be left to the economists.

These hindrances to the spread of trade unionism are not the only ones. A union formed among factory workers or general labourers derives part of its strength from the fact that its members are all within one fairly narrow income bracket and draw a solidarity from being always engaged in definitely subordinate duties. A union embracing all bank employees, on the other hand, has the duty of representing both the junior typist and the senior manager, two persons with very different attitudes to the exercise of authority. Then there is the man, often admirable on the counter or as a securities clerk, whose abilities do not entitle him to further advancement; the divergence between his views on the correct division of the salary fund and the views entertained by the man marked out for promotion may be so great as to make an appeal to common action meaningless.

The last obstacle to the creation of a militant banking trade union among Englishmen is the human material involved. Up to now, the great majority of bank men have come from middle-class homes where the values implicit in the workers' upward struggle have been hardly recognized as existing; instead, the virtues of independence and hard work have been stressed as the necessary foundation of a satisfactory competence. Formed by the influences playing on his childhood, the new recruit on entering a bank finds himself in a world he understands. He is of the same social class as his manager and has the same chance of rising in the service, for in the joint-stock banks everybody starts at the bottom and there are no directors' sons pushed into

nice jobs half-way up the ladder. During his first fifteen years the clerk undergoes his apprenticeship, since good bankers are not made in a day; thereafter, advancement is a keenly competitive business and his progress forms the subject of reports not only from his manager but also from visiting inspectors. Thus the lessons he learned as a child are fortified by his experience as a man—he is in a world of social equality where promotion is to the able, where graft and nepotism do not enter and where, at the end of it all, the brother of the imposing chief general manager may be a deserving cashier who has long given up the hope of preferment but has not ceased to accept the assumptions behind his upbringing. Whether those assumptions will survive the continued pressure of inflationary Government finance is another question altogether.

CHAPTER 9

THE BANKER, THE CUSTOMER AND THE LAW

Most **CUSTOMERS** of banks go quite happily through life in ignorance of the various laws governing the conduct of their accounts. Yet it is a good thing to know the why and wherefore of the acts one is called upon to perform, particularly when they are of a financial nature, and this chapter is intended to answer a few of the questions that at one time or another arise in the minds of those who draw cheques or come into contact with banks in other ways.

JOINT ACCOUNTS: It is not uncommon for a husband to arrange for his wife to operate on his account. The usual form of instruction that the bank gets him to sign gives the wife powers as wide as he enjoys himself, so he must not grumble if he discovers later on that his wife has pledged jointly-held securities to cover an overdraft. As a matter of practice, a bank always tries to get both parties' signatures to a form of pledge, just to avoid misunderstandings, but on the wording of the customary mandate letter it is under no legal obligation to take this precaution.

There is one big drawback to a mandate—it ceases with the giver's death. So Mr. Smith, if he wishes Mrs. Smith to be able to draw money from his account, will do better to make the account a joint one in their two names, with either to sign. The advantage of doing so is made explicit by a clause in the letter of instruction stating

that the account is to be 'with benefit to survivor', meaning that if either party dies, the other can go on drawing cheques just as before. Of course there may be death duties to pay if the money is the property of the deceased, and there may be legacies payable under the will, but all that is for the survivor to settle with the legal representative of the deceased and is no concern of the bank, which will continue to honour the cheques of the remaining party as long as the balance is sufficient and as long as no restraining order of the Court is served.

CHEQUES: For legal purposes a cheque is treated as a species of the genus 'bill of exchange'. This gives rise to various kinds of inconvenience and banking will become a simpler business when the old-fashioned Bills of Exchange Act, passed at a time when cheques were far less numerous, is replaced by a statute better suited to modern conditions.

Cheques are the only banker-customer contractual documents which the majority of customers meet with frequently. They are unconditional orders in writing addressed by a customer to his banker and payable on demand. In England it is quite legal to postdate a cheque, but a banker who pays a cheque before its date can be made to recredit the account and it follows that banks greatly dislike the customer who issues such things. The drawing of a cheque seems to be a kind of *pons asinorum* and every day banks reject hundreds of orders because of their irregularity. The absence of a date is immaterial (any holder has the right to insert one), but a cheque will usually be refused where words and figures differ, although a banker has the right to pay according to the words. A customer who loses his cheque book or who leaves it lying about is an unpopular person because

of the danger of forgery. If a banker pays a cheque on which the drawer's signature is forged he is liable to his customer, even though the forgery is perfectly executed, except in the very rare cases where the drawer has himself acted so as to mislead the banker: this liability arises from the fact that the banker has paid on what is not, in fact, his customer's order. The banker is also liable if he pays a cheque whose amount has been altered by a forger, unless the customer has been so negligent in drawing it (as by omitting the words and leaving tempting gaps in the figures) that forgery has been much facilitated.

A customer, when ordering a cheque book, may be asked whether he wants 'open or crossed' and he may wonder what the difference amounts to and whether it really matters. It may matter a good deal. A crossed cheque is one which cannot be debited to the drawer's account unless the person presenting it for payment presents it through a bank: that is, the presenter must have a bank account and so the cheque can be traced on its journey from collecting bank to paying bank and the person whose account has been credited can, in case of need, be interrogated as to how he came into possession of it.

The simple crossing by parallel transverse lines, an operation which a drawer or holder may if he wishes perform for himself, is the first change that can be made. There are other refinements, however, which are not unusual. A crossed cheque may bear a mystic and incomplete '& Co.': this means nothing and can be safely ignored: but the cheque may also be crossed with the name of a particular bank and this means that it must be passed through the account of a person having an

account with that bank. Two other markings appearing on crossings need elucidation. The first is 'not negotiable'. These words have a special legal meaning which it would take too long to explain fully and yet they are of such importance that their significance should be made clear to anybody who draws cheques. If a person (such as a tradesman) cashes a cheque for a customer, he takes the cheque and usually becomes entitled to the money represented by it; but if the cheque is crossed and bears the words 'not negotiable' along the crossing he can have no better title than the person had who transferred it to him—so if he has taken it from a thief, he can have no title.

The other refinement is to write 'a/c payee' along the crossing. Once that has been done, any bank placing the proceeds of the cheque to the credit of a person other than the one named as payee is liable to the true owner of the cheque should there have been any fraud. In the ordinary way, most people are honest about cheques but anybody who has to send a cheque by post will be wise to insure against trouble by crossing it and adding 'a/c payee'. *Prima facie* the post is held to be the agent of the sender but if a payee asks for payment by cheque through the post then he becomes responsible: and, generally, he will protect himself by instructing the sender to cross the cheque to a particular bank.

Fortunately for most of us cheques are not only debited but also credited, and this brings us to endorsements—and to deciding what is a proper endorsement. One of the leading textbooks on banking practice devotes about ten pages to examples of correct and incorrect endorsements, and even so there is room for doubt in marginal cases. This is all very silly and there is much

to be said for the United States rule that the payee's marks on the back of the cheque should agree with the description on the front. However, until we change our complicated ways we must put up with the daily refusal of hundreds of cheques, 'endorsement irregular', and the only advice which can be offered here to payees is that if they are in doubt they should take their cheques to the nearest bank in order to get guidance.

It sometimes happens that a drawer will want to stop payment of a cheque he has sent to somebody: he may have changed his mind about the worthiness of the beneficiary, or the cheque may have gone astray. His first step will probably be to telegraph or telephone to his bank and a little care at this stage is advisable. The stop order should mention not only the amount, date, and payee's name but also the number of the cheque, and the message should always be confirmed immediately by letter.

The drawer is the bank's master in this and must be obeyed. Sometimes, however, it is a careless payee who, having mislaid a cheque, tries to prevent payment. In theory, his only remedy is to ask the drawer to instruct the bank to refuse payment, a course which may merely result in bolting the stable door after the horse has been stolen. Fortunately, most banks are ready to listen to a bona fide cry for help whose aim is to prevent the commission of a fraud, so a payee who has lost a cheque and cannot get into immediate touch with the drawer will do well to write to the bank explaining the circumstances. Thereafter he must be content to hope for the best: he has received the cheque and cannot demand another, he is unknown to the bank, which is under no obligation to accept his story but is under an obligation

to honour its customers' cheques when these appear to be regular.

BORROWING : Most of what is said in the remainder of this chapter is for the benefit of borrowers and of any who may feel moved to guarantee the debts of others. A banker is obliged to reject many requests for overdrafts, one of the most frequent reasons for refusal being that the petitioner cannot give any good indication of when repayment may be expected. As has been pointed out earlier, a banker is not a pawnbroker to whom the selling up of a pledge is a normal part of the day's work. Every unrepaid loan is a criticism of a banker's judgement, even though it is covered by ample security, and bankers always feel unhappy when they have to 'sell up'. Subject to this word of warning it is yet true that bankers want to lend, and an idea regarding the hierarchy of security may not be out of place. In the last resort, there is none better than that comprised in the undoubted good name of the customer. Unfortunately for some customers, the judgement as to the quality of their names does not lie with them, but with a lender who adds to long experience an unwillingness to darken with a mistake the last years of his banking career. When we come to specific security, we find customers offering all sorts of things. There is unimpeachable Government Stock, house property, insurance policies, and even expectations derived from the promises of unpleasantly healthy old uncles. The last will be rejected out of hand by bankers unwilling to regard faith as the substance of things hoped for, but all the rest will be gladly accepted provided they will fetch more, on a forced realization, than the sum lent.

One of Polonius' sententious maxims concerned the unwisdom of being either a borrower or a lender. It is

not recorded what he thought about guarantors, those people who voluntarily stand surety for the debts of others, and it is possible that he considered their folly to be beyond even his powers of description. As far as most non-commercial borrowing proposals are concerned, the banker's advice to intending guarantors (if asked) would be that of *Punch* to those contemplating marriage. But as *Punch* might admit, not all marriages are failures; and there have certainly been many young men soundly established who might never have achieved their goal but for the willingness of a third party to take on himself the onerous burdens of a surety. In England, a guarantor is a much protected person *unless* he contracts away all his common law rights—and this is what he does when he puts his name to a bank's form of guarantee. Let him make no mistake, the lender will regard him as the principal debtor if it suits the lender's book, and the guarantor's rights against the borrower will stand postponed to the bank's. If these considerations do not restrain the intending surety, then let him go ahead.

But where the guarantor is not a 'he' but a 'she', a banker will step warily, particularly if the lady is offering to guarantee her husband's overdraft. The law still presumes that husbands exercise a measure of influence over their spouses and so a banker usually suggests that it would be just as well were the nature of the guarantee obligations to be explained to the wife by her lawyer before she signs.

SECURITY: It has often been said that in a small town everybody knows everything about everybody. This should not be true of one's banking affairs, for a banker is under a contractual duty of secrecy in regard to his customers' accounts, and one bank, at least, reminds its

entire staff annually of this. There are a few judicially approved exceptions to the general rule, but the ordinary private customer is unlikely to be affected by them. So important is this obligation of secrecy that it is held to endure after an account has been closed—anything that passed during the existence of the account must continue to be regarded as confidential.

This duty is performed admirably by British bankers and not a little of the high esteem in which they are held all over the world derives from the knowledge that absolute trust may be reposed in them.

CHAPTER 10

THE FUTURE OF BANKING

BEFORE 1914 British banking rested upon certain assumptions, and a great deal of the superstructure remained apparently serviceable after the loosening or removal of the foundations; but the continued confidence that as things had been so would they remain was due to a lack of percipience which, though excusable in the general public, seems almost unpardonable in any leading banker. A reading to-day of the speeches made by bank chairmen in the years immediately following the First World War shows that even those who should have known better thought that, for Britain, four years of European dislocation could be wiped out, that progress could be resumed from where it left off, and that 'progress' was synonymous with the reinstitution and continuation of the old general scheme of things.

It would be wrong for us, heirs of the stormy and perhaps equally misleading light of a later day, to remain satisfied with picking out the comfortable fallacies of our progenitors. The events of 1939 onwards have hardly provided a good testimonial to our own clear-sightedness and the most we can do now is to recognize, somewhat belatedly, that we are in the midst of one of those periodic bankruptcies of the European community that have occurred with greater or lesser violence ever since the fall of the Roman Empire.

It would be too much to expect, in a world where whole regions are given over to what is little better than

economic anarchy, that the banking system of one of the principal belligerents should not feel the changes which have made a desolation that even the victors dare not call peace; and the banker is, in a way, particularly vulnerable to criticism. The boilermaker, the farmer, the electrical engineer, all these live out a working life largely protected from outside judgement by reason of its technical intricacies. The banker's tricks of the trade, on the other hand, are, when they are explained, hardly worthy of even a third-rate magician, and his ultimate virtue, that of sound appraisement of short-term risks, is so largely a matter of feeling fortified by experience that it cannot be convincingly demonstrated except by the broad results. It therefore comes about that there are many people, some very learned and some very ignorant, who feel called upon to point out the errors of our banking system, and in these times of upheaval there have been suggestions that banking has suffered such radical changes that it has really ceased to be banking at all in the sense in which that word was understood in the good old days.

Any book on banking written thirty years ago would have been quite clear as to the main function of a bank. It was to provide funds for the current working requirements of the industries of the country. The fund out of which the provision was made was the deposits, and these were basically created by the savings of trusting people. Advances were limited to financing short-term requirements (at least that was the ideal) because were money to be lent or invested in other ways it would be difficult to mobilize quickly when it might be needed to meet an unusually heavy demand for cash by depositors. This was the doctrine of Liquidity and, in adherence to it, a

banker (after making provision for normal cash reserves) tried to use such money as he could not lend in self-settling overdrafts to buy commercial bills, to lend to the billbrokers for very short periods, and to invest in Government bills having not more than three months to run. Anything left over after that went into purchases of Government stock, but as this asset was liable to depreciation (Consols fell 25 per cent. between 1900 and 1914) it had to be regarded with watchful suspicion and with the knowledge that the needful moment to sell out would probably coincide with a time of crisis when stock prices were falling.

As they look back at this structure, as familiar to Bagehot in 1860 as to Holden of the Midland Bank fifty years later, observers can see at a glance that two big changes have taken place. The first is the fall in the ratio of capital and disclosed reserves to liabilities. Different calculations have given differing results but the broad trend is undisputed: here are some figures put forward by Geoffrey Crowther, the editor of *The Economist*.

Percentage Ratio of Capital and Reserves to Total Liabilities

1881	1913	1925	1943	1946 ¹
16.3	8.9	6.8	4.0	2.4

The figure for 1881 is that to be expected from the existence of a large number of separate banks, none of them very big: it was a suitable proportion for the pre-amalgamation days. By 1913 concentration had made great strides and deposits had risen under the expansionist influences associated with the increase of gold production in a gold standard world. By 1925 the amalgamation movement had run its course and the

¹ Author's estimate.

deposits, horribly swollen by the inflationary finance of 1914-19, had failed to contract in spite of the squeeze of trade depression. Already there were critics who argued that the proportion of capital and reserves to deposits was become too low, but a second war was to show that the banking system could carry on with a still lower ratio. Two-thirds of the way through the Second World War 92 per cent. of liabilities were represented by deposits, compared with 77 per cent. in 1881 and 87 per cent. in 1925, while the support of capital and reserves had fallen to a mere 4 per cent. Three years later, at the end of 1946, the two sets of figures were 9.4 and 2.4 per cent. respectively—and still the prophets of disaster failed to attract much of a hearing.

What is the danger? Would it make a scrap of difference were the directors of our banks to go further and distribute the reserves to the shareholders, thereby halving the already tiny proportion? The answer lies on the other side of the balance sheet, in the item called Investments. The proportion of investments to total assets rose slowly from 12.8 per cent. in 1881 to 15.4 per cent. in 1925. The misleading practice of many banks of lumping together discounts and advances makes it impossible to say with certainty how far commercial lending lost ground to the discounting of Government bills between 1914 and 1925, but the following rough estimate, which we also owe to Geoffrey Crowther, is probably somewhere near the truth:

Percentage Distribution of Bank Assets

	1881	1913	1925	1943
Cash and Call Money .	18	24	21	18 $\frac{1}{2}$
Lent to Public .	61	54	51	19 $\frac{1}{2}$
" " Government .	15	15	21	58
Sundries . . .	6	7	7	4

From this table it is plain that the banks' dependence on Government credit for their earnings has enormously increased in recent years. An immediate consequence is that even a small percentage fall in the market value of Government obligations will make a nasty hole in the assets side, other things being equal. Capital and reserves, the argument runs, should together be sufficient to cover any likely depreciation in the investment portfolio, and yet here we are in the situation where a 10 per cent. depreciation in investments would wipe out the whole of the paid up capital and disclosed reserves. Because they are secret, it is impossible to say how far the hidden reserves could go to make up a fall in asset values of this magnitude; but at the close of 1946 the clearing banks' investments were shown at £1,425 million, and a tenth of this is a formidable sum of money even in these days when millions are spoken of in a light-hearted fashion.

What are the objections to the banks going to the public in order to raise the quantity of additional capital envisaged? The answer may be put in the form of another question—What could the banks do with the capital when it had been raised? It could not be used for advances and trade discounts, for these assets depend on a customer-demand which is presumably already satisfied; its purpose would be defeated were it used to plunge further into Government-sponsored paper; its only 'liquid' home would be Cash, where it would earn nothing. Things may come to that yet but there are other possibilities, since the pattern of interest rates is not immutable and the same forces that depress the value of the National Debt may bring about a greater demand for bank accommodation from the commercial classes.

This brings us to the second striking change. Deposits can no longer be considered simply as people's 'savings'. During the years between 1938 and 1946 they rose from £2,254 million (clearing banks) to £5,681 million partly as a result of the need of waging war, a need that could only be served by a certain measure of that tax-collecting process called inflation. Partly, however, this rise was an expedient to keep money rates low. This is clearly seen if the figures for the end of 1945, when major war expenditure had ceased, are compared with those of a year later. Instead of the decrease in deposits which the innocent might have expected, there was an increase of £837 million, much of which had been pumped into the monetary system by a Chancellor of the Exchequer who saw that the only way to borrow cheaply was to flood the market with the means to 'invest'. Analysis of the plentiful but rather tangled evidence shows that the general public did not do much during this particular year in the way of purchasing Government paper: indeed, when we take into account the sales of gilt-edged securities by industrial concerns bent on the acquisition of ready money, net buying by outsiders must have been small. The burden of supporting the Chancellor's drive thus fell on what are called 'institutional' investors, of whom the banks are the biggest. It is they who have had to absorb the industrialists' sales and it is they who have had to lend to the money market.

In an earlier chapter we described how the use of deposits in order to finance commerce had suffered diminution as a result of the amalgamation movement among industrial undertakings. Since 1945 the scope for this kind of lending has been further narrowed by reason of the various nationalization schemes. The coal

mines and the railways have already disappeared from the private sector and, for the future, their borrowing requirements will be met by the Government acting on the money market. Other industries await their turn to pass under what their directors regard as the Caudine Forks, and with their passing the advances component will suffer yet another squeeze.

With the level of deposits subject to almost endless Government manipulation, and with the outlets for genuine commercial advances constantly being narrowed, it is useless to say that our banks are not being driven to depart more and more from the pattern developed through the two hundred and fifty years which lie between the shop at the Sign of the Unicorn and the establishment of the Big Five. Yet we must remember that this wholesale rearrangement has occurred over a very short period, a highly exceptional period, during which Britain's exchanges with the rest of the world have been subjected to strict control. That period of insulation may soon draw to a close and no man can tell how far the traditional outlines will reappear as the forces which originally shaped them resume their sway.

CHAPTER II

OTHER MEN'S BANKERS

IN THE modern world, wherever a country has enjoyed a long period of civilization, the structure of its banking system usually bears within it numerous traces of the country's past history. Of no country is this more true than of the United States of America, that great nation whose financial leadership has to-day become a necessity to the rest of the world. To many people the U.S.A. still stands as the land of free enterprise, the land where the restraining and meddling hand of the State is laid but lightly on the capitalist entrepreneur, and then only to prevent the evils of monopoly. That this picture has survived the enormous mass of restrictive legislation put through by Congress during the long Roosevelt administration is a tribute not only to the continued existence of great areas of industrial liberty but also to the strength of the legend of untrammelled opportunity that arose out of the exceptional conditions of the nineteenth century.

Yet one industry, that of banking, attracted the attention of federal legislators over eighty years ago, and that attention has never since been relaxed. Nor can the early measures be accused of timidity, for the National Bank Act set out to establish an entire banking system. There were already in existence some 1,600 banks, chartered under the various laws of the then thirty-four states. These banks had their own note issues, most of which were useless outside the locality of the issuer, but as there was no universally accepted currency except an

insufficient quantity of coin, the country had to get on as best it could with the rickety credit organization at its disposal until a better one was evolved.

The needs of the Federal Government after the Civil War gave an impetus to the reformers' zeal. In a country acutely short of capital, a network of reliable banks was a *sine qua non* for the marketing of Government securities. Banks were also needed as depositories for Government funds and to act as the fiscal agents of the distant Treasury at Washington. The state banks were suspect, and rightly so, for many of them were formed under charters so lax as to be worse than no rule at all, and the wide differences in their constitutions made them in any event an unsuitable instrument for carrying out a uniform policy.

From its inception the national banking system was based on a firm belief that bankers need to be watched very carefully. The popular distrust of the Money Power was strong in the minds of a people the majority of whom were agriculturalists and independent artisans. Thirty-four years were to pass before William Jennings Bryan of Nebraska was to stump the country with the cry that mankind should not be crucified upon a cross of gold, but the feeling that animated him was equally alive among the rural contemporaries of Lincoln and is reflected in all Congress's dealings with the bankers. The Act of 1863 created a special Treasury department to control the new national banks and placed over it a powerful and legally independent official called the Comptroller of the Currency. The Comptroller supervises the organization, chartering, and regulation of the national banks formed under the Act; he has the duty of inspecting these banks and is dowered with wide

powers to interfere with those whose conduct is displeasing to him. Over 5,000 national banks are in existence to-day and every one of them has to comply with regulations governing minimum size of capital, number of directors, permitted activities, and (very important) the amount of cash reserves to be maintained. All along, the opening of branches has been generally discouraged so that only about 200 national banks possess more than one office.

Every national bank has to make frequent reports of its position to the Comptroller, and on the position of any affiliates. This, however, is a mere trifle compared with the examinations which the Comptroller regularly carries out at the cost of the banks themselves and in the course of which bank directors can be questioned under oath. How effective all this legal paraphernalia has proved in practice will be seen when we come to consider the formation and operation of the Federal Reserve System.

Set over against the 5,000 national banks are the 9,000 banks formed under and controlled by the laws of the forty-eight states of the Union. The wide differences between many of the codes makes impossible any omnibus description of state banks but certain features tend to reproduce themselves. There is usually a state bank commissioner with a squad of inspectors at his orders and he normally possesses many of the powers exercised by the national banks' Comptroller. As a rule, branch formation is not encouraged (California forms an important exception) and in nearly all state codes there are strict requirements as to the maintenance of minimum cash reserves. The general attitude of distrust is well exemplified by the frequency of regulations limiting the activities of bank directors and officials: in the state of

New York, for example, they are prohibited from concurrent employment in any business engaged in the buying and selling of securities, except with the permission of the state authority. Directors who borrow from their banks find themselves liable to make various declarations and statements. In Kansas, any officer accepting a deposit when his bank is in a failing condition becomes individually responsible for any loss the depositor may sustain, while in state after state boards of directors are cramped by the threat of personal liability for losses arising from sundry kinds of risk-taking.

The United States made shift for half a century with these two systems of supervised banking. During the early years the national banks tended to grow in strength at the expense of the state banks, since they acquired a virtual monopoly of note-issue. With the passage of time, however, note-issuing in the U.S.A., as in England, became of less and less importance as a source of profits and a number of banks decided to give up the privilege of forming part of the national system and took out charters under the generally more lax state laws.

In 1913 Congress made a fresh attempt to establish banking on a better basis. Experience had revealed serious flaws—the issue of bank notes and credit was unduly inelastic, the major parts of all banks' reserves tended to be concentrated in a few big New York institutions, there was no national clearing system, no proper bill market, no lender of last resort, and bank failures involving heavy losses to depositors were still far too common. Some of these evils had been present in English banking during the first three-quarters of the nineteenth century but they had been corrected by action taken within the industry, particularly through

the strengthening of banks by amalgamation and by the spreading of risks following the development of an extensive network of branches. In the United States, public opinion would never have permitted a bank to cover several states, and it therefore became the duty of the legislature to devise other methods which would at once secure solvency, maintain honest dealing, and allow sufficient play to the profit motive.

During the whole of the important period between the first setting up of the national banks and the passing of the Federal Reserve Act, the country had been without anything resembling a central bank. Twice in the early history of the Republic had Congress chartered a central bank for a twenty-year period and twice had political animosity proved strong enough to prevent a renewal of the charter. The lack of a strong central institution was felt every time there was a commercial crisis, but it was not until the shortcomings of the banking structure were fully revealed in the great smash of 1907 that it became possible to attack the problem in a fundamental manner. A commission was then set up, and out of its recommendations was formed the Federal Reserve System under which the United States has successfully weathered the storms of two great wars.

The Federal Reserve Act provides an interesting example of how the Americans endeavour to reconcile the presence of strength at the centre with wide local freedoms. Under its provisions the United States, excluding Alaska, are divided into twelve Federal Reserve districts, each of which contains a Federal Reserve city with a Federal Reserve bank, and every national bank has to subscribe to the capital of its district Federal Reserve bank.

The central direction is provided by the Federal Reserve Board at Washington. This board consists of the Secretary of the Treasury, the Comptroller of the Currency (whom we have already seen at work as supervisor of the national banks), and six additional members appointed by the President with the approval of Congress and so chosen as to give the various geographic sections of the country a kind of proportional representation. As might be expected, this powerfully manned board has wide authority. It supervises the issue of Federal Reserve notes and regularly examines the affairs of the twelve Reserve banks and of the commercial member banks of the system. The notes, which are an obligation of the Treasury, are issued to the Federal Reserve banks at the board's discretion and must be accepted by everybody as legal tender. Up to 1933 they were redeemable in gold at the Treasury but since the suspension of the gold standard in that year they have been convertible.

The duties of a Federal Reserve bank are closely defined. It has to maintain a fixed proportion (at present 25 per cent.) of gold certificates—Treasury receipts for gold—against its notes in circulation, and the same proportion against its deposits. These deposits come from the member banks, each of which is bound to establish and maintain reserve balances bearing a minimum ratio to the demand deposits (current accounts) and time deposits of its customers. The legal proportion depends on the will of the Federal Reserve Board and its power to fix reserve requirements is a powerful weapon in controlling the total volume of credit.¹

¹ At the close of 1945 reserve requirements for member banks in the big cities were 20 per cent. of demand deposits and 6 per cent. of time deposits.

Just as important is the board's legal authority to fix the sum that member banks can lend to people who want to borrow on the security of stocks and shares. On all stock exchanges prices are subject at times to big fluctuations, but as the air of the United States seems peculiarly stimulating to both booms and slumps gambling in securities offers more than its usual attractions. A growing social conscience, strongly supported by the jealousy of those who themselves have neither the means nor the skill to operate, has led to a progressive restriction of buccaneering in bonds and one of the most potent restraints is the power of the Federal Reserve Board to fix margins which borrowers have to deposit before they can be supplied with bank money to plunge deeper into the stock market.

The national banks automatically became members of the Federal Reserve System, but under the Act any state bank may also be admitted provided it can fulfil the necessary conditions. This concession has proved a valuable one (at the end of 1945 state member banks totalled nearly 1,800, being 21 per cent. of all state banks and holding 69 per cent. of all state banks' deposits) for the various Federal Reserve banks are empowered to discount bills for members. In England, as we have seen, the commercial banks do not seek discount facilities from the central institution—that side of financing is attended to through the mechanism of the billbrokers—but in most countries of the world, including the U.S.A., the absence of what the British regard as a properly developed money market makes it necessary for banks to have direct discount access to some central body.

There have been several amendments to the Act of 1913. One of the most interesting was made in 1933,

insuring depositors against failures among the commercial banks. The insurance is arranged through the Federal Deposit Insurance Corporation, a public body half of whose capital is contributed by the Treasury and the remainder by the Federal Reserve banks. Every member bank pays a premium based on the total of its deposits and, in return, the deposits of each of its customers are fully insured up to \$10,000, higher sums being partially insured. As the spate of failures in the period immediately prior to the formation of the Corporation had made the public very conscious of the benefits of insurance, the safety now offered induced many banks, particularly the weaker ones, to enter the Federal Reserve System. Some, however, have been refused admission, for they have been unable to pass the Comptroller's entrance examination. Every bank seeking the benefits of the F.D.I.C. has to be certified as solvent; its financial history is considered, the adequacy of its capital, its earning capacity, and the general character of its management. Once it has passed these tests and been accepted, a bank has to submit to further inspections as and when the Corporation sees fit and it may not merge with an uninsured concern without permission.

In addition to the protection afforded by the requirements of the Federal Reserve System and by the banking codes of the various states, there are also the safeguards introduced by the autonomous clearing house associations. There are several of these bodies and each has rules by which its members are governed. The New York association, for instance, will not admit a bank to membership unless the applicant has a satisfactory capital, while any member may be expelled by a majority vote. We have already described the impor-

tance of the big clearing house in London: how it brings together the heads of banks who, once brought together, find an increasing area of common ground. In the United States there has been some sharp criticism of this type of collaboration and clearing house associations have been accused of making a ruthless use of their power. The charge is probably not without foundation but the actions complained of have sometimes been in the public interest, as when members of the New York association in 1930 agreed not to facilitate the speculative activities of outsiders in the short-term money market.

When the English banker reads of the elaborate machinery of control provided by the Federal and state laws of the U.S.A. his first reaction is one of thankfulness that British banking has hitherto escaped similar legislative leading strings, and his next thought is to wonder how it was that in spite of all the precautions already existing it was possible for nearly 20,000 American banks to fail in the thirteen years from 1921 to 1933, some of them years of pretty fair prosperity. The published evidence points to one main reason for this shocking record—bad banking. In more detail, it may be ascribed to dishonesty and peculation, speculative investments, risky operations in real estate, and, generally speaking, an overvaluation of weak assets. Doubtless much of the Government and state inspection was of a superficial nature—how could it have been otherwise when thousands of banks had to be examined at least once a year?—but the number of failures suggests that even in the absence of dishonesty successful banking is not as easy as it ought to be in the United States. Many of the losses have been due to the unit system so strongly favoured by law and custom, and many others would not have

crippled the losers had it been easy to spread risks over a wide area. To have all your eggs in Detroit or in a corner of Alabama is to be uncomfortably at the mercy of local ups and downs and to be constantly tempted to invest too large a proportion of the deposits in assets likely to freeze at awkward moments. In New York, which is incomparably the largest financial centre, the period between 1919 and 1930 witnessed a brisk amalgamation movement among the big banks, and to-day concerns such as the National City Bank have larger deposits than most English banks; but even so, the number of competing institutions is far greater than the number of clearing banks in London. Apart from this, strength through fusion has been little favoured and the improvement in solvency since the disastrous year 1933 has been due chiefly to the return of prosperity, the enormous expansion of business activity in states such as Texas and California, and the higher standards of banking prescribed by amendments to the Federal Reserve Act.

One aspect of the Federal Reserve System's influence can be seen in the expansion of American banking overseas. Whereas British banks pushed out all over the world without any encouragement from Parliament, the growth of similar venturing by United States concerns has been directly due to legal enactments. The development of their extensive international facilities dates from the passage of the Federal Reserve Act, which authorized the larger national banks to establish branches and affiliates abroad. The response was at first vigorous and by 1920 the number of overseas offices had reached 181, but amalgamations and, more still, the losses and misfortunes of later years brought about such a reduction that by December 1945 only 72 offices remained open.

These branches are widely spread but are particularly influential in Latin America, where they constitute valuable gatherers of information for the great industries operating at home.

We have already commented on the large American establishments maintained in London but we shall look in vain for British counterparts in the United States. Though foreign banks may operate, either through agencies or subsidiary companies, they have to comply with state laws, and no agency can be opened in New York unless an application is filed setting out a detailed financial statement: even when a licence is granted the grantee bank is so restricted that it is not permitted to conduct a general banking business. A number of foreign banks have gone a step further and organized separate companies under state jurisdiction, but the few that have been so established have usually confined their activities to a narrow range.

The outstanding manifestation of the U.S.A.'s interest in the finance of foreign trade is the Export-Import Bank, an impressive witness to the inadequacy of the commercial banks as stimulators of overseas trade development. It started life in a modest way in 1934 but eleven years later was turned into a Government agency with power to make loans of almost any type provided they are to assist United States foreign trade. As a rule its credits are granted only to finance the purchase of materials produced or manufactured in the U.S.A., and care is taken to refrain from competing with private banks—not a difficult task while these are in their present unadventurous mood. The funds at 'Ex-Im's' disposal are subject to Congress regulation; in the summer of 1947 they totalled \$3,500 million and, of this, \$1,770 million

had actually been allotted to borrowers, Europe being the principal beneficiary. A good example of Ex-Im lending is the loan of \$100 million to Italy under the Italian Government's guarantee that 15 per cent. of the raw materials needed by the trades concerned should be bought from the United States.

These great credit lines supplemented the work of U.N.R.R.A. while that body still functioned, and they have done much to ease the various strains on the United Nations since then. It is inconceivable that this money for the rehabilitation of half a world could have been obtained from the American commercial banks, whose record as foreign lenders has been one of alternating rashness and conservative timorousness, and the debt owed to Ex-Im by mankind is greater than any that can be expressed in books of account.

So widespread has been the financial and commercial influence of the United States on Canada that it is the differences between their two systems of banking that are surprising rather than the similarities. Both countries are organized on a federal basis and both have had to contend with the difficulty of co-ordinating the productive activities of widely scattered settlements. The United States' response to these conditions was the unit system of banking but it finds no echo in the Dominion, where the community's needs are attended to by a few commercial banks, three of which dominate the scene by reason of their nation-wide string of branches. In many other respects there are striking resemblances, but this major dissimilarity is worthy of note as a manifestation of the English, or rather Scottish, influence.

Prior to the British North America Act of 1867 the banks were formed under charters granted by one or

other of the four provinces into which Canada was then divided, but after Confederation took place the granting of charters was made a federal responsibility rather on the lines of the National Bank Act in the United States. The charters have always been subject to decennial revision, a provision which in theory endows the parliament at Ottawa with a wide measure of control, but the outstanding result of the Dominion Bank Act seems mainly to have been to protect established institutions against the arrival of fresh competitors.

On the whole, the banks conduct business on much the same lines as English banks. Until recently they drew a valuable income from their note-issues, but this source of profit has been withdrawn from them since the central bank, the Bank of Canada, was granted a note-issuing monopoly. Banks are obliged to keep reserves equal to 5 per cent. of their deposit liabilities in the form of a deposit with the central bank. This does not seem a high figure, but it has to be maintained against time deposits as well as demand deposits, and as the reserves cannot be drawn against they constitute what is in effect a blocked guarantee fund, so that a further reserve has to be kept in order to meet day-to-day needs. Every bank is subject to an annual federal inspection and to a shareholders' inspection undertaken by officially approved auditors, but the federal examinations (unlike those in the U.S.A.) are made at the cost of the taxpayer.

Canada has been the scene of widespread settlement during the past sixty years, and as the railways opened up province after province the banker followed close on the heels of the farmer, the prospector, and the miner. Under these conditions, land became widely owned and widely offered as security to lenders. The income from crops

and the price of the earth from which the crops spring are both of them liable to sharp fluctuations in a climate such as Canada's, so that were agriculturalists left to the free use of their desperate remedies a bad cycle of years might see much of their land forfeited to unsatisfied mortgagees. To protect the farming interest the Canadian Bank Act has decreed that though land can be mortgaged it may only fulfil the role of additional cover, the borrower being compelled to offer some other type of property to the bank as a primary security; and not satisfied with this, the Act goes on to limit the way a foreclosing bank can deal with the property rights in any land it takes into its hands. On the whole, the banks welcome these provisions, for without them the relation between the prairie provinces and the financier would be much more unfriendly than it already is during periods of low cereal prices—and that is saying a good deal, as the history of Alberta's relations with the Federal Government has amply demonstrated.

The framework of Government inspection and all the rest of the paraphernalia of central control has been adopted more or less wholesale all over the American continent, but the history of the southern republics during the past few years has shown that the possession of powers of this type provides an authoritarian ruler with a weapon that may be used for ends that could never have been foreseen by the ardent democrats who drafted the National Bank Act. Thus in the Argentine the commercial banks have become mere agencies of a central bank which is itself but an instrument to serve the aggrandizement of a dictator. That the system has hitherto worked smoothly is due partly to the fact that the central bank makes satisfactory payments for the

services its agents perform and partly to the phase of great prosperity through which the country is passing; but a financial climate is being created in which banking judgement and self-respect must become atrophied.

Nowhere has the delicate balance of powers necessary to the successful working of capitalist banks under central supervision been better understood and observed than in the little federal republic of Switzerland, a country which has been the laboratory of more than one interesting legislative experiment. Until 1934 it was like Britain in that it possessed no special commercial banking law, although various proposals had been discussed in the years immediately preceding the First World War. It needed the consequences of the great depression and the German financial crash to convince this independent and careful people that some kind of central control was, for them, preferable to unregulated enterprise. The lessons had been severe. The Swiss banks were favoured depositories of foreign funds, and therefore particularly susceptible to panics abroad; on top of this, geography, race, and interlocking economies had brought Switzerland and her great northern neighbour into very close business relations: so when German commercial external debts froze overnight even the biggest Swiss creditors found themselves in difficulties and forced to cut their losses in ruinous fashion. It was to prevent a recurrence of these troubles that the law of 1934 was passed.

Broadly speaking, there are three types of commercial bank in Switzerland. First come the twenty-four cantonal banks, which bear a resemblance to the U.S.A. state banks in being subject to local law, but differ from them in being state-owned. The statutes governing them vary from canton to canton, so that while some of them have

risen to the topmost rank of commercial banks others have remained little more than minor mortgage institutions.

Next come the ordinary joint-stock banks. The failures of 1931 and the further losses on German investments during the Second World War have combined to reduce their number so that there are to-day only three of them of any size. Both they and the cantonal banks have what seems to us the curious habit of raising working funds by the periodic issue of short-term debentures, and both classes of bank have in the past made great efforts to attract foreign business. Side by side with them are the private bankers, the third category, numerous still but of sadly reduced importance.

The federal law of 1934 has succeeded in leaving normal banking operations reasonably untrammelled. It is administered by a small Commission whose expenses are borne by the Federal Government which presents an annual report to the Federal Council. All banks, other than the cantonal banks, have to secure the Commission's approval of their articles of association, and these have to state clearly the operations in which it is proposed to engage. This provision exists in order to make it easier to keep a watch on the activities of the large number of concerns performing a mixture of banking and finance house business, and it calls into play all the ingenuity of company lawyers to get round its object. The capital of a bank has to bear a minimum ratio to its liabilities (the nature of 'capital' is carefully defined), but far more rigorous in appearance are the clauses describing the different categories of assets and the proportion they must bear to liabilities. 'Disposable' assets consist of balance sheet items such as cash, free foreign currencies

and money held with the National Bank, while 'easily mobilizable' assets include bonds, bills discountable at the National Bank, deposits with other banks maturing within a month, and foreign acceptances maturing within three months. Liabilities are divided into short-term and other, the former being those falling due within a month. Starting with these definitions, the Act proceeds to set out a table of ratios linking the amount of disposable and mobilizable assets to the liabilities. The minimum statutory proportions are not unreasonable and no sound bank should find difficulty in observing them, but they do at least serve the purpose of setting up a standard of right practice.

Except for those private bankers who conduct their business without appealing to the public for capital, Swiss banks have to issue balance sheets in a prescribed form and—a much more drastic type of disclosure—profit and loss accounts of an extremely detailed nature. A comparison of the profit and loss account of a Swiss bank with that of an English bank will at once demonstrate the superiority of the former when considered as a medium for giving information, but it is one of the paradoxes of business that even the most blameless disclosure may lessen rather than increase public confidence, so that the reticence shown in Britain may perhaps not be as retrograde as it would at first appear when set against the Helvetian practice of open confession.

Certain direct relations with the National Bank are obligatory. Each commercial bank has to send in a copy of its annual accounts and before it enters into various specified kinds of venture it must notify the National Bank, which has the power of veto. This limitation on enterprise was designed to prevent a recurrence of the

type of loss sustained by those banks which had invested largely in Germany, but the experience of 1939-45 showed that a more stringent watch needed to be kept and the central bank's authority has been more rigorously exercised since the second period of banking troubles.

Apart from one or two provisions, the federal law does not bear hardly on a well-managed bank—and most Swiss banks are admirably managed. The general confidence of the community was strikingly demonstrated when the defeat of Hitler brought about what amounted to the failure of two of the biggest of the joint-stock banks. Their deposits and remaining real assets were quickly taken over with the National Bank's blessing by two more fortunate competitors and what might have turned into a major catastrophe passed off as if it had been no more than a normal fusion of important enterprises—still, one more lesson had been provided that good commercial banking cannot be created by even the most far-sighted legislation but only by good bankers so strongly placed as to be free from the influence of outside interests.

From time to time Swiss banks have tended to identify themselves too closely with businesses of a non-banking nature. Germany, however, is the country where banks have carried furthest the practice of direct investment in industry and their habit of so engaging their deposits was not without British admirers, though these were among our schoolmen rather than our bankers. The holding of shares or controlling interests in productive concerns came about as a result of the terrifically rapid advance of industrialism in a country where the small wealthy class of the old society had little interest in manufacturing processes. The gap created by their abstention was filled by the banks, which were not slow to see that there were

certain solid advantages to be obtained from owning a majority holding of ordinary shares in prosperous companies. The result, nevertheless, was bound to be an immobilization of funds in times of business recession and a crash in the hour of a first-class business crisis. It was the tying up of its money in the Nordwolle textile concern that brought the great Darmstaedter Bank to the ground in 1931, thus giving the signal for a general collapse involving almost every bank in the country.

The collapse was followed by a reconstruction under Government direction, and when the banks resumed their normal life in 1932 they found that half their capital was owned by the Reich—those who had once controlled so largely were now themselves controlled. When the Nazis seized power they found in the shackled banking system exactly what they needed. Within a year they had passed a Banking Act which rightly endeavoured to break interlocking banking-industrial directorates and to suppress the grant of large credits to connected concerns; but the main reforms, if such they can be called, are those associated with the name of Dr. Schacht, whose task was to systematize default, to build banking into the totalitarian state, and to subordinate it to the ends which were openly declared to the world when Poland was invaded in August 1939.

One of the most striking early results of the Second World War was a leftward swing in nearly all the victor countries, and in Western Europe it was particularly noticeable in France. Up to 1936 the French had tolerated, rather than approved, a system completely free from control except that the State appointed the powerful Governor of the Banque de France. In that year the newly-formed Popular Front placed the central

bank (though still in private ownership) under the authority of the Government and ten years later both it and the biggest joint-stock banks were nationalized. It is too early to assess the social consequences of the post-war socialization of commercial banks, more especially as the changes have occurred in a period of almost unparalleled economic difficulties; and even were they favourable, it would not necessarily follow that in other countries a similar medicine could be relied upon to produce equally beneficent results. France stands uneasily to-day halfway between free banking as exemplified in Britain and the completely socialized variety familiar in the U.S.S.R. Perhaps the lack of obvious good results in France is partly due to an unwillingness to accept the logic of socialism, but a more likely cause is the waste that occurs when any industry is nationalized, be it baking or banking, and the new rulers are not clear as to what to do with it next.

No such uncertainties have darkened the minds of the Marxists in Moscow. To them, it was plain that the role of banking must be ancillary to the current Plan handed down from headquarters. Banks in such circumstances become nothing more than instruments of State policy, whether logical or empiric, and their original form is dissolved so that it can be reshaped into a fresh series of banks representing, not the result of capitalist competition in a capitalist country, but apparently nothing more than book-keeping offices for the different branches of a controlled production machine. Before the late war it was not surprising that this lay-out gave rise to talk of a moneyless economy in which there could be no room for banking; but the gap between talk and reality is substantial and Soviet banks grant and withhold credits

still. After the first revolutionary phase of revolt and expropriation, credit crept back and was used first as a means of securing a proper proportion between investments in the different branches of production and secondly as a means of keeping a check on the efficiency of industrial establishments. Once the early hopeful orgy was over, factories were compelled to work within given credit facilities and the ordinary banks (if any banks in Russia can be so called) were prohibited from giving short-term facilities in competition with Gosbank, the central state concern. Out of the disorder arose a recognizable socialist pattern—the Prombank, specializing in financing industrial investment in capital goods; the Selkhozbank, performing similar functions for agriculture; the Co-operative Bank, financing the long-term requirements of the Co-operative retail shops; and the U.S.S.R. Bank for Foreign Trade. The funds of these banks were derived from the deposits of their compulsory customers and from Government grants, and every bank was compelled (as are commercial banks in most capitalist countries) to keep balances with the central bank, which works in close collaboration with the inner circle responsible for the national economic plan.

The purpose of Soviet banking was to maintain a satisfactory balance between different kinds of productive and distributive activity. Four years of war dislocated the entire economy but already the pre-1941 demarcations are fast reappearing and whatever changes in nomenclature may occur we may expect that much of the former pattern will be adopted and adapted to serve the needs of the vast industrial expansion which, given peace, will be one of the decisive developments of the latter half of the twentieth century.

Outside Great Britain there is hardly a country, whether capitalist, socialist, or mixed, where banks have been allowed to pursue their trade without being subjected to some form of control devised to deal with banks as banks; and yet there can hardly be any country with a history so free from banking failure as ours has been over the past half century. There are those who see in the nationalization of the Bank of England the beginning of the end of our system of self-rule and unfettered discretion: and they may be right, for in a rapidly changing world the radical alteration of our banking system may prove but one unavoidable result of a plan to avoid an entire breakdown of the national organism. Yet when the present incumbents of old Lombard Street look back at the enormous influence British banking has had on the world's development during the past century they may be excused for believing that an extinction of the old tradition will leave a blank which no carefully thought out scheme of regimentation will ever fill.

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